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1. AGENCY USE

Sep 93

3. REPORT TYPE AND DATES COVERED

THESIS/ DISSERTATION

4. TITLE AND SUBTITLE

Defense Contractor Recovery of Cleanup Costs at Contractor
Owned and Operated Facilities

5. FUNDING NUMBERS

6. AUTHOR(S)

Cherly L. Nilsson

7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)

AFIT Student Attending: George Washington Univ

8. PERFORMING ORGANIZATION
REPORT NUMBER

AFIT/CI/CIA- 93-139

9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)

DEPARTMENT OF THE AIR FORCE
AFIT/CI
2950 P STREET
WRIGHT-PATTERSON AFB OH 45433-7765

10. SPONSORING/MONITORING
AGENCY REPORT NUMBER

11. SUPPLEMENTARY NOTES

12a. DISTRIBUTION/AVAILABILITY STATEMENT

Approved for Public Release IAW 190-1
Distribution Unlimited
MICHAEL M. BRICKER, SMSgt, USAF
Chief Administration

12b. DISTRIBUTION CODE

13. ABSTRACT (Maximum 200 words)

DTIC
ELECTE
JCT 06 1993
S A D

93-23214



122 pgs

14. SUBJECT TERMS

15. NUMBER OF PAGES

121

16. PRICE CODE

17. SECURITY CLASSIFICATION
OF REPORT18. SECURITY CLASSIFICATION
OF THIS PAGE19. SECURITY CLASSIFICATION
OF ABSTRACT

20. LIMITATION OF ABSTRACT

**DEFENSE CONTRACTOR RECOVERY
OF CLEANUP COSTS AT
CONTRACTOR OWNED AND OPERATED FACILITIES**

By

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A Thesis submitted to

The Faculty of

**The National Law Center
of The George Washington University
in partial satisfaction of the requirements
for the Masters of Laws**

September 30, 1993

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Frederick J. Lees
Professors of Law**

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CHAPTER I
DEFENSE CONTRACTOR RECOVERY
OF CLEANUP COSTS AT
CONTRACTOR OWNED AND OPERATED FACILITIES

I. INTRODUCTION

This thesis discusses the Department of Defense's (DOD) obligation to reimburse defense contractors for environmental cleanup costs for "releases" of hazardous substances occurring at contractor owned and operated (COCO) facilities¹ or disposal sites for which the contractor is held responsible as a "Potentially Responsible Party".² Its primary focus is on recovery of cleanup costs under the Federal Acquisition Regulation (FAR) cost principles³ and on the 1980 Comprehensive Environmental Response Compensation and Liability Act (CERCLA) §107(a)(3), which allows contractor reimbursement when the government arranged for the treatment or disposal of hazardous substances used in performing

¹A contractor owned/contractor operated facility is a non-government owned, privately operated facility that provides goods and/or services to a federal agency under contract. The term "release" means any spilling, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment of any hazardous substance. (§42 U.S.C.A 9601 (22))

²42 U.S.C.A. §9607, CERCLA §107; RCRA §3004(u) and the myriad of state hazardous waste cleanup programs.

³FAR Part 31, 48 C.F.R. §31.00 *et seq.*

the government contract.⁴

The Department of Defense enters into thousands of contracts each year with COCO's for the performance of work ranging from simple paint contracts to manufacture of sophisticated multi-million dollar weapon systems, many with significant environmental cleanup costs.⁵ Environmental laws enacted as a direct result of the Love Canal disaster of the late 1970's have resulted in government contractor liabilities for cleanup associated with hazardous wastes long since believed to have been disposed.⁶ The costs are staggering and the stakes are high.⁷ In addition to the high cost of the actual cleanup, there are substantial costs for remedial investigations and evaluations, governmental administration, future monitoring, fines, penalties, legal and professional fees, personal and property

⁴42 U.S.C.A. 9607(A)(3), CERCLA 107(a)(3). The mechanism for "reimbursement" under CERCLA is a suit by the contractor for contribution pursuant to §113(f)(1) to recover damages from the government for its share of the costs as a "Potentially Responsible Party" under CERCLA §107(a).

⁵The term cleanup costs used throughout the thesis refers to costs of all remedial obligations relating to past activities of the contractor or former owners of the property (42 U.S.C.A. §9607(a)). According to the GAO, the cleanup estimates from 15 of DOD's largest contractors for past environmental costs range from \$5.4 million to \$423 million and future costs range from \$1.1 million to \$710 million, GAO Report, *Environmental Cleanup: Unresolved Issues in Reimbursements to DOD Contractor*, GAO/T-NAIAD-93-12).

⁶Robert T.Lee, "Environmental Liability: Uncertain Times for Government Contractors", 23 National Contract Management Journal 45, Issue 2 (1990).

⁷The average cost of cleaning up a site on the EPA Superfund list is \$25 million, with a cost of some sites nearing \$100 million. At the same time, purchases of goods and services are expected to fall from \$150.6 Billion in 1989 to \$122.3 billion in 1997. BNA Federal Contracts Daily, Regulatory Outlook, February 13, 1991.

damages, and regulatory overhead.⁸

Defense contractors, like their commercial counterparts are involved in cleanup of hazardous materials and wastes that were stored, shipped, dumped or used without adequate containment. They face substantial liability under state and federal law for damage caused by contaminants leeching into the soil and ground water. A recent GAO study on COCO liability noted:

"aggregate projections range from \$0.9 billion to \$1.1 billion...one contractor, spending \$9 million for investigation of one site and projected that another \$91 million would be needed to construct and operate ground water treatment facilities for cleaning up the site...another contractor said it could be responsible for cleanup costs at 100 sites involved with defense contracts..."⁹

Liabilities created by environmental statutes are broad in scope and almost limitless in time.¹⁰ The debate today for contractors and the government is not whether environmental cleanup costs are necessary, but "who picks up the tab".¹¹

⁸42 U.S.C.A. 9601 *et seq.*

⁹United States General Accounting Office, *DOD Environmental Cleanup: Information on Contractor Cleanup Costs and DOD Reimbursements*, Fact Sheet For Congressional Requesters, June 26, 1992.

¹⁰Marc F. Effron & Devon Engle, "Recovery of Environmental Costs", 93-3 Cost, Pricing & Accounting Report 3-14, March 1992.

¹¹Jerry A. Batschi and Lynda Troutman O'Sullivan *Recovery or Environmental Prevention and Cleanup costs by Government Contractors*, 32 Contract Management 20, April 1992; Peter A. McDonald and Scott P. Isaacson, *Environmental Costs for Government Contractors*, *Gordian Knot Redux*, 57 FCR 22, June 1, 1992; John F. Seymour, *Liability of Government Contractors for Environmental Damage*, 21 Public Contracts Law Journal 1992, Summer 1992.

It is the intent of this paper to outline the extent to which the contractor can recover these costs from the government under existing statutory and regulatory contract principles, or in the alternative as a "potentially responsible party" under CERCLA 107(a)(3): "arranger" liability.¹²

A. Federal Environmental Law Governing Liabilities for Past Activities.

CERCLA¹³ and the Resource Conservation and Recovery Act of 1976 (RCRA)¹⁴ are the primary federal statutes governing the responsibilities and liabilities for past hazardous waste activities. RCRA, though it primarily focuses on current safe management of hazardous waste, has three provisions governing past activities.¹⁵ CERCLA, however is the most comprehensive federal statute, and was

¹²42 U.S.C.A. 9607(A)(3), CERCLA 107(a)(3)

¹³42 U.S.C. § 9601 et seq.

¹⁴42 U.S.C.A. § 6921 et seq. The Resource Conservation and Recovery Act of 1976 (amended the Solid Waste Disposal Act (SWDA) of 1965, 42 U.S.C.A. 6901-6991) 42 U.S.C.A. § 6921 - Subtitle C of SWDA § 1002 et seq. In addition to the federal statutes, virtually all states have enacted their own "mini-superfund" laws, with far reaching cleanup and liability provisions.

¹⁵Provisions governing past activities are: § 3004(u) Permit Conditions; § 7003 "Imminent Hazard" provisions; and § 3013 "Monitoring, Analysis and Testing", address contamination from past conduct. RCRA § 3004(u) requires that permits issued for active or closed waste management units, include provisions requiring corrective action for all releases of hazardous waste, regardless of the time at which waste was placed in the unit. RCRA § 7003 gives the EPA authority "to bring suit...against any person (past or present generator, transporter, owner or operator of a treatment, storage or disposal facility) who has contributed to "the handling, storage, treatment or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment". RCRA

designed to remedy contamination from past practices. It is therefore the primary focus of this thesis.

CERCLA provides the legal framework under which federal and state governments, as well as private parties respond to and clean up contamination in land, air and water caused by releases of hazardous substances. The act requires responsible parties to clean up a contaminated site, or reimburse the government or other private parties for the cost of cleanup.¹⁶ Liability for cleanup under CERCLA extends to past and present owners, transporters, and generators of hazardous substances (also called "arrangers") and is strict, joint and several.¹⁷ Current owners are normally liable for cleanup costs even if they did not own the property at the time of the disposal or cause or contribute to the release of the contaminant.¹⁸

CERCLA imposes reporting, cleanup requirements, and liabilities on four categories of "persons"¹⁹ also called "Potentially Responsible Parties" (PRP) who (1)

§3013 authorizes the EPA to order the most recent owner or operator, who could reasonably be expected to have actual knowledge of the presence of hazardous waste at a facility, to do the requisite monitoring and testing.

¹⁶42 U.S.C.A §9604, §9611.

¹⁷42 U.S.C.A §9607(a).

¹⁸New York v. Shore Realty Corp. 759 F2d 1032, 1044 (2d Cir. 1985)

¹⁹42 U.S.C.A 9601(21). The term "person" is defined as an individual, firm, corporation, association, partnership, consortium, association, commercial entity, United States Government, municipality, commission, political subdivision of the

currently own and operate a facility²⁰; (2) owned or operated a facility at the time of the disposal of a hazardous substance;²¹ (3) by contract, agreement, or otherwise, arranged for disposal or treatment of hazardous substances²²; and (4) accepted any hazardous substance for transport to a disposal or treatment facility, selected by that person.²³ CERCLA's 1986 amendments, the Superfund Amendment and Reauthorization Act (SARA), specifically provide that CERCLA applies to facilities owned or operated by a department, agency, or instrumentality of the United States, "in the same manner and to the extent" it applies to other facilities.²⁴

Where the cleanup site is owned and operated by a DOD contractor, there is potential government liability for hazardous waste cleanup if DOD owned or operated a facility at the time of the disposal, or arranged for disposal or treatment of hazardous substances related to the performance of a government contract.²⁵

state, or any interstate body.

²⁰42 U.S.C.A. §9607(a)(1), CERCLA §§107(a)(1). *See also*, 42 U.S.C.A. §9601(9): "Facility" means any building, structure, installation, equipment, pipe or pipeline...well, pit, pond, lagoon, impoundment, ditch, landfill, storage container...any site or area where a hazardous substance has been deposited.

²¹42 §9607(a)(2)

²²42 U.S.C.A. 9607(a)(3)

²³42 U.S.C.A. §9607(a)(4)

²⁴Pub. L. No. 96-510, 94 Stat. 2762 (codified in part as amended at 42 U.S.C.A. 9601-9657)

²⁵42 U.S.C.A. §9607(a)(2)&(3). Disposal is the discharge, deposit, injection, dumping, spilling, leaking, or placing of any solid waste or hazardous waste into or on any land or water so that such solid waste, hazardous waste or any constituent thereof may enter the environment or be emitted into the air or discharged into any

Causation requirements are minimal. Potential "arranger" liability requires only that the (a) generator disposed of, or arranged for the disposal or treatment of a hazardous substance at the site, (b) hazardous substances like the generator's are still present at the site, (c) there has been a release of a hazardous substance, and (d) the release has triggered the incurrence of response costs.²⁶

PRP's are liable for response costs, which include short-term removal and long-term remedial actions, incurred by the Federal government, a state or others that are "consistent" with the National Contingency Plan²⁷; damage to government owned or controlled natural resources; the cost of health assessments or studies; and

waters, including ground waters, 42 U.S.C. §6903(3). *See also* Letter from James F. Hinchman, General Counsel, U.S. General Accounting Office to The Honorable John Conyers, Jr., Chairman Committee on Government Operations, House of Representatives, February 3, 1992, B-246822.2.

²⁶United States v. Wade, 577 F.Supp.1326 (E.D.Pa. 1983). There is no requirement that the "arranger" control the disposal U.S. v. Aceto Agricultural Chemicals 699 F. Supp. 1384 (S.D. Iowa W.D. 1988), *aff'd in part, rev'd in part* 872 F.2d 1373 (8 Cir 1989); or have knowledge of the facility where waste was disposed, State of Missouri v. Independent Petrochemical Corp. 610 F. Supp 4 (E.D. Mo, 1985).

²⁷Part 300, Subchapter J- "Superfund, Emergency Planning and Community Right-To-Know Programs", Subpart A §300.1, 55 FR 8813, March 8, 1990. The National Oil and Hazardous Substances Pollution Contingency Plan, *also referred to as* The National Contingency Plan (NCP), 40 CFR 300, provides the organizational structure and procedures for preparing for and responding to discharges of oil and releases of hazardous substances, pollutants, and contaminants. Pursuant to 42 U.S.C.A. §9607 (a)(4)(A), a PRP is liable for "all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan," and under §9607 (a)(4)(B) a PRP is liable for "any other necessary costs of response incurred by any other person consistent with the national contingency plan."

interest from the date payment is demanded.²⁸

CERCLA liability and costs are triggered by a release or a substantial threat of a release (spilling, leaking, pumping, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing) into the environment of a hazardous substance.²⁹ These costs, by their very nature may be the result of conditions existing prior to existing government contracts. They may or may not be the subject of a citation from federal or state authorities, and it doesn't matter whether the actions leading to the contamination were intentional or unintentional. The costs may be the result of standard business practices at the time, during which the contractor may or may not have been working on government contracts, and often arise from conditions and practices from which the liability and impact was unknown or unforeseeable at the time they were undertaken.³⁰

As a "no fault" statute, CERCLA imposes liability even when the contractor's activities causing the damage were in full compliance with the law at the time. A PRP's claim that it exercised due care or was not negligent, cannot be used to avoid liability. There are only three complete defenses to CERCLA liability that, as a practical matter, provide little protection to contractors. They are: (1) An act of God;

²⁸42 U.S.C.A. §§9607(a)(4)(C)&(D)

²⁹42 U.S.C.A. §9604(a) and §9601(22)

³⁰John F. Seymour, *Liability for Government Contractors For Environmental Damage*, 21 Public Contracts Law Journal, 492-500, Summer 1992; Margaret O. Steinbeck, *Liability of Defense Contractors for Hazardous Waste Cleanup Costs*, 125 Mil. L. Rev. 55 (1989).

(2) An act of war; and (3) An act or omission of a third party exercising due care, other than an employee, agent of, or one whose act or omission occurs in connection with a "contractual relationship" with a PRP.³¹

DOD and its contractors will rarely be able to avoid liability using the listed defenses, since contractors typically experience a release and resulting damages in the course of normal operations that cannot be easily characterized as acts of God or an act of war. Neither will the third party defense be available, since the release and resulting damages typically arise as a result of some act or omission of a contractor's employee, agent, or subcontractor.³²

B. Government Procurement Principles Relevant to Environmental Liabilities.

Part 23 of the FAR sets for the government's procurement policy in support of compliance with environmental laws:

It is the Government's policy to improve environmental quality. Accordingly, executive agencies shall conduct their acquisition activities in a manner that will result in effective enforcement of the Clean Air Act and Clean Water Act³³

The fact that procurement policy supports an environmental improvement

³¹42 U.S.C.A. 9607(b)

³²B-246822.2: Letter from the GAO General Counsel to John Conyers, Chairman, House Committee on Government Operations, February 3, 1992.

³³FAR §23.103(a). In addition, with limited exceptions, FAR §23.103(b) precludes executive agencies from entering into, renewing, or extending contracts with firms proposing to use facilities listed by EPA as violating the Clean Air and Water Acts.

program, does not translate into a separate obligation to fund the program at government expense and does not confer any special status on contractors as to compliance with Federal, state and local laws.³⁴ The FAR does not expressly address the risk of loss for environmental liabilities although it requires contractors to comply with clean air and water standards and the applicable state and local laws on hazardous materials management.³⁵ There are no provisions that directly address whether environmental costs are allowable under the contract. The closest thing to FAR guidance is a controversial draft cost principle that, to date, has not been published as a proposed rule.³⁶

The proposed cost principle would allow contractors to recover costs for preventing pollution, complying with applicable environmental laws and regulations, and disposing of waste. However, to recover cleanup costs the contractor would be required to show that it (or the previous owner responsible for the contamination) was performing a Government contract at the time the condition requiring cleanup occurred, performance of the Government contract contributed to the creation of the

³⁴Thomas H. Truit, Susan D. Sawtells, *et al.* The Environmental Liabilities of Government Contractors and Agencies, Federal Publications, Inc. Washington D.C. 1992, p. 301

³⁵FAR §52.223-2; §52.223-3.

³⁶Proposed FAR §31.204-9, agreed on by federal agencies in May 1992, unpublished due to the Bush administration's moratorium on new federal regulations imposed February 1992. According to Sherri Wasserman Goodman, Deputy Under Secretary of Defense (Environmental Security) the administration is "reexamining" the draft cost principle. *Statement of Sherri Wasserman Goodman Before the United States House Representatives Committee on Government Operations, Subcommittee on Legislation and National Security*, May 20, 1993. See also, 59 Federal Contracts Report, No. 20, 681,682, May 24, 1993.

condition, it was exercising reasonable business judgment, complied with all environmental standards applicable at the time the condition was created, acted promptly to mitigate the condition and exhausted or is diligently pursuing all available legal avenues to recover or defray the cleanup costs. In addition under the proposed draft, costs resulting from liability to a third party would be unallowable.³⁷

Until further official FAR guidance, defense contractor recovery of environmental costs for past activities will be treated like other costs not specifically addressed in the FAR and will depend on the type of contract (cost-reimbursement and fixed-price), the existing standard FAR clauses, contract provisions unique to the specific contract, and agency guidance.³⁸ In cost reimbursement contracts, the

³⁷Proposed FAR 31.205-9. Numerous industry and bar groups have opposed the cost principle primarily because it makes environmental costs presumptively unallowable. In addition, it is their view that expecting the contracting officer to determine compliance with then-applicable environmental laws and industry standards is thought to be unworkable. *Letter from Allan J. Joseph of Rogers, Joseph, O'Donnell & Quinn to Mrs. Eleanor Spector, Director of Defense Procurement, Re: Environmental Cost Principle*, January 14, 1992. BNA Federal Contracts Daily "DOD Environmental Cost Principle", August 13, 1992. However, others view it as a reasonable and fair attempt to allocate responsibility for environmental cleanup costs. BNA Federal Contracts Daily, "Burman Rejects Industries Pleas to Rescind Controversial FAR Cost Principle", December 18, 1991.

³⁸ For examples of judicial decisions on the treatment of environmental costs for fixed-price contracts, see RPM Construction Company 1990 WL 85421 *6, ASBCA No. 36,965, 90-3 BCA 23,051 (specific warranty clause guaranteeing the underground tank will be leak proof); Holk Development, Inc. ASBCA No. 40,137, 90-2 BCA 22,852 (specific requirements in specifications for asbestos removal); Gulf Contracting Inc. ASBCA Nos. 27221 *et al.* 84-2 BCA 17,472 (Clause requiring payment of applicable Federal, State and local taxes made contractor responsible for taxes imposed after award); and Permis Construction Corp. ASBCA No 39, 613, 90-3 BCA 23,070 (Protection of environmental resources clause). There are no cases deciding reimbursement of environmental cleanup cost on cost-type contracts. In October 1992, the Defense Contract Audit Agency (DCAA) and DOD jointly issued

contractor is reimbursed for the allowable costs incurred in the performance of the contract, while in fixed price contracts the contractor is paid a price for performing the work, not affected by the cost of performance. In a cost reimbursement contract, unless a cost is expressly unallowable, reasonable costs, allocable to the government contract are reimbursed by the government. In contrast, in a typical fixed-price contract, the price is preestablished, so additional, unforeseen costs incurred during performance will not be reimbursed.³⁹ Accordingly, in a cost-type contract, contractors are reimbursed for their reasonable and allocable environmental cleanup costs and in fixed price contracts, recovery of unanticipated environmental costs is significantly more limited.

Chapters II and III will discuss in detail the conditions under which environmental cleanup costs incurred during performance of a government contract

audit guidance on the allowability of environmental costs (DCAA Memorandum for Regional Directors, 92-PAD-163(R), which is governing the government auditors at present. The guidance provides that "environmental costs are generally allowable costs if reasonable and allocable". According to Sherri Wasserman Goodman, Deputy Under Secretary of Defense (Environmental Security), "If environmental damage occurred despite the exercise of due care by a contractor which complied with specific laws and regulations and conducted its business in accordance with standard industry practices, if that contractor has spent reasonable amounts in a cost-effective manner to remedy environmental damage, and if that contractor has vigorously sought reimbursement from all available contributory sources ... it may be that the U.S. government should pay its fair share, but only its fair share of that contractor's costs." *Statement of Sherri Wasserman Goodman, Deputy Under Secretary of Defense (Environmental Security Before the United States House Representatives, Committee on Government Operations, Subcommittee on Legislation and National Security, May 20, 1993, as quoted in 59 Federal Contracts Report 680, May 24, 1993.*

³⁹John Cibinic, Jr. and Ralph C. Nash, Hr. Formation of Government Contracts 705 (2nd ed.) The George Washington University, 1986.

are reimbursed in fixed-price and cost-reimbursement contracts. Chapters IV and V will discuss post contract performance recovery of cleanup cost under CERCLA to the extent the contract "arranged for" the disposal of hazardous substances.

CHAPTER II
CONTRACTOR RECOVERY OF INCREASED COSTS
DURING PERFORMANCE
OF
FIXED PRICE CONTRACTS

I. INTRODUCTION

The most frequently used type of contract is the fixed-price contract. Such contracts can be either firm fixed price or a fixed price, subject to adjustment during or after performance.¹

A firm fixed price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor *maximum risk and responsibility* for all costs and resulting profit or loss.²

Generally, in fixed price contracts, all environmental costs are borne by the contractor unless there are specially negotiated provisions or the cost is treated as a compensable change to the contract.³ The courts have allowed recovery of additional costs of compliance with environmental regulations on the grounds of "differing site conditions" and post award constructive changes in the contract

¹John Cibinic, Jr. & Ralph C. Nash, Jr. Formation of Government Contracts 715, The George Washington University, Government Contracts Program, (2nd ed, 1986)

²FAR 16.202-1

³Marcia G. Madsen, Thomas F. Williamson, Glenn G. Wolcott, *Management Contractors and Environmental Damage, Who Shall Pay?*, 37 Federal Bar News and Journal 601 (1990).

requirements, notwithstanding the significant limits of the "Permits and Responsibility" clause.⁴ None of the published cases address recovery of environmental cleanup costs from the contractor's past activities,⁵ however they are illustrative of the requirements for recovery of any environmental costs incurred during the performance of a fixed price contract.

A. Differing Site Conditions

Under the "Differing Site Conditions" clause, the contractor can recover additional costs of performance when

(1) subsurface or latent physical conditions at the site, differ materially from those indicated in the contract, or (2) unknown physical conditions at the site, of an unusual nature, differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract.⁶

This clause was designed to relieve the contractor of the risks incurred with

⁴FAR §52.236-2 (Differing Site Conditions clause); FAR §52.243-1 (Changes Clause, Fixed-price Supply Contracts); FAR §52.243-4 (Changes Clause, Fixed-price Construction Contracts). The "Permits and Responsibility" clause (FAR §52.236-7) requiring the contractor to comply with all Federal, state, and local laws, insures that contractor recovery of environmental costs is the exception rather than the rule.

⁵There is virtually no basis for post performance cleanup cost reimbursement under fixed price contracts. See Atlas Corporation v. United States, 895 F.2d 745 (Fed. Cir 1990) *cert den.* 498 U. S. S. 811, 11 S. Ct. 46, 112 L. Ed. 2d 22 (Oct 1, 1990) where the court rejected theories of mutual mistake, implied contract, constructive contract, and "taking".

⁶FAR §52.236-2

certain types of unexpected unfavorable conditions encountered during performance.⁷ However to take advantage of the relief offered, the contractor must conduct a reasonable inspection and review the relevant contract documents. In Frank Lill & Sons, the contractor was successful in securing a price adjustment for the increased cost of asbestos removal, even though the contract gave notice of the existence of asbestos, because the contractor was not able to determine after a reasonable preperformance inspection of the site, the extent of the asbestos. The board concluded that the contractor:

Encountered a latent physical condition materially different from that indicated in the contract specifications ... This latent condition was not as to the existence of asbestos at the site, which the contract indicated but as to the quantity of asbestos which required removal. This is consistent with the Differing Site Conditions Clause policy of permitting contractors to rely on contract indications unless simple inquiries might have revealed contrary conditions.⁸

Similarly, in D.J. Barclay & Co. the board granted the contractor partial relief for the added expense of removing asbestos insulation, that neither the government nor the contractor knew existed and could not have been discovered during a reasonable site inspection.⁹ In contrast, the board denied a contractor's \$49,000 differing site conditions claim for the removal of asbestos in areas allegedly not indicated in the

⁷John Cibinic Jr., Ralph C. Nash, Jr. Administration of Government Contracts, Chapter 5, *Differing Site Conditions*, 2nd ed. Government Contracts Program, The George Washington University, 1985

⁸Frank Lill & Sons 1988 WL 63464, ASBCA No. 35,774, 88-3 BCA 20,880

⁹D.J. Barclay & Co. ASBCA Nos. 29005 and 30250, 88-2 BCA 20,741.

contract, because the contractor failed to make a pre-bid site inspection, which would have revealed the likelihood of asbestos. In addition, its subcontractor recognized the likelihood of asbestos prior to its bid and the contractor instructed them to ignore it.¹⁰

Contractors have also been entitled to relief when the government knew or should have known of a condition that necessitated an increased cost of performance and failed to disclose the information to the contractor. In one of the first published environmental cost recovery cases, the court ordered additional costs for asbestos removal when the government failed to disclose its existence, noting:

We have found no case, like the instant one, in which the information withheld relates to the presence of a toxic substance affecting the public health. In these circumstances, we believe, the party possessing actual knowledge has a higher duty to reveal because of the greater likelihood that the presence of such a substance would affect the cost of the project and because a reasonable contractor who is not required by contract to test for toxic substances would be lulled into complacency by the failure to reveal the presence of such substance.¹¹

Similarly, the contractor in Darwin Construction Company was entitled to an equitable adjustment when the government knew that the asbestos required more than ordinary procedures, did not inform the bidders, and the contractor had no way of knowing of the asbestos problem, even with a reasonable inspection.¹²

¹⁰Diamond Pacific, NASA BCA No. 45-0391, 92-1 BCA 24,615.

¹¹Active Fire Sprinkler Corp. 1984 WL 13904 *56 (GSBCA).

¹²Darwin Construction Company 1985 WL 17331 *3, ASBCA No. 27,596, 86-1 BCA 18,645

2. Changes during Contract Performance

The changes clause gives the government the unilateral right to order changes during the course of performance and gives the contractor the right to an "equitable adjustment" if the change increases the cost or time of performance.¹³ Compensable changes can be the result of direct oral or written orders by the contracting officer or other government acts or omissions that result in changes (1) in the specifications; (2) the method or manner of performance of the work; (3) in the government-furnished facilities, equipment, materials services, or site; or (4) by directing acceleration in the performance of the work.¹⁴ In Active Fire Sprinkler Corp., when the contracting officer ordered changes mandated by the EPA, the contractor was entitled to an equitable adjustment because the order changed the method of performance of the work.¹⁵ Generally, there is no recovery for the added cost of compliance for changes required by environmental regulations during

¹³ See FAR §52.243-1, changes clause used in fixed price supply contracts and with minor modifications, for service contracts and FAR §52.243-4, changes clause for fixed price construction contracts.

¹⁴FAR §52.243-4.

¹⁵Active Fire Sprinkler Corp., 1984 WL 13904, GSBICA No. 5461, 85-1 BCA 17,868. The court also found relief based on "mutual mistake" because both the government and the contractor had been mistaken as to the cost impact of the regulations. See Cibinic & Nash, Administration of Government Contracts Chapter 3, *Risk Allocation*, *supra* note 7, for discussion on remedies for mutual mistake. See also Atlas Corporation v. United States, 895 F.2d 745 (Fed. Cir. 1990) *cert. den.* 498 U.S. 811 (1990) where court rejected mutual mistake theory for recovery of cleanup costs incurred as a result of performance of prior government contracts.

the course of performance.¹⁶ However in this case, the imposition of special procedures and precautions, not found in the statutes or regulation, were compensable.¹⁷ The court noted:

Although the parties recognized the existence of the Clean Air requirements in the contract provisions, neither envisioned that the NESAs [sic] emission standard was to be implemented to require special procedures for handling asbestos, and neither assumed the risk of performing in accordance with them.¹⁸

Similarly, contractors have been successful in recovering additional costs when the contractor performs work beyond that required by the contract without a formal change order, when it is perceived that such work was informally ordered by the government or caused by government fault.¹⁹ There are four general categories of such constructive changes: (1) Disagreements between the parties over the contract requirements; (2) Defective specifications and government non-disclosure of

¹⁶Warner Electric, Inc., 1985 WL 16602 *5, VABCA No. 2106, 85-2 BCA 18,131. The contractor was not reimbursed for the extra costs of polychlorinated biphenyl (PCB) removal from a VA Medical Center because the Board determined it was not the discovery of the PCB's, but the change in the EPA regulations which increased the cost. The government is not liable for the increased costs resulting from regulations issued in the exercise of the sovereign power of the United States.

¹⁷Active Fire Sprinkler Corp., 1984 WL 13904, GSBCA No. 5461, 85-1 BCA 17,868, dealt with costs incurred pursuant to the Clean Air Act, and the National Emissions Standards for Asbestos (NESA). Subsequent cases with a "Permits and Responsibility" clause in the contract have not followed this logic. *See discussion on "Permits and Responsibilities" clause, this chapter.*

¹⁸Active Fire Sprinkler Corp., 1984 WL 13904 at *4.

¹⁹Cibinic & Nash, *supra* note 13 at 322.

information; (3) Acceleration; and (4) Failure of the government to cooperate during performance.²⁰ In Long Services Corp. where there was a disagreement on the interpretation of the contract requirements, the board found a constructive change when the government did not permit the contractor to use a less expensive asbestos removal method that was consistent with industry standards, in compliance with the law, and not prohibited by the terms of the contract.²¹

However, there was no recovery in those cases where the increased costs were the result of a contractor's negligence, or the expense was covered by the "Permits and Responsibility" clause or another clause in the contract.²² The contractor in D.J. Barclay & Company was not entitled to the additional costs for asbestos removal caused by its failure to protect the insulation from the effects of sandblasting.²³ Absent the contractor's negligence, the insulation would not have required removal or presented a health hazard. Similarly, reimbursement for the cost of cleanup of a PCB spill during the removal of a transformer was denied

²⁰*Id.* at 324

²¹Long Services Corp. PSBCA No. 1606, 87-3 BCA 20,109, *aff'd on reconsideration*, 88-1 BCA 20270. *In contrast see* Permis Construction Corporation, ASBCA No. 39613, 90-3 BCA 115,835 where the contractor's interpretation was found to be unreasonable and failure to continue performance pursuant to the contracting officer's direction, pending resolution of the dispute, were grounds for default termination.

²²*See* CECOS International, Inc., IBCA No. 1667-3-83, 84-1 BCA 85,069, 85,070 where the contractor was not reimbursed for an assessment on hazardous waste disposal imposed after contract award, where the contract provided that the "contract price includes all applicable Federal, state, and local taxes and duties".

²³D.J. Barclay & Company, ASBCA Nos. 29005 and 30250, 88-2 BCA 20,741

because the proximate cause of the spill was the mishandling by the contractor's employees.²⁴

3. Permits and Responsibilities Clause

A significant limitation on cost recovery in fixed price contracts is the "Permits and Responsibility Clause" required in all fixed price construction, dismantling, demolition, or removal or improvement contracts.²⁵ It provides:

The Contractor shall, without additional expense to the Government, be responsible for obtaining any necessary licenses and permits, and for complying with any Federal, state, and municipal laws, codes, and regulations applicable to the performance of the work. The Contractor shall also be responsible for all damages to persons or property that occur as a result of the Contractor's fault or negligence, and shall take proper safety and health precautions to protect the work, the workers, the public, and the property of others.²⁶

The thrust of the clause is to impose on the contractor the cost of incurring all necessary expenses including the unexpected.²⁷ This clause requires contractors to comply with laws and regulations passed subsequent to award without additional compensation, unless there is another clause in the contract that limits the clause to

²⁴McCullough Engineering and Contracting, VABCA No. 3088, 91-3 BCA 24,056

²⁵FAR §36.507; FAR 52.236-7.

²⁶FAR 52.236-7

²⁷Vasallo Construction, Inc., 1992 WL 196153, BSBCA No. 3067 (July 14, 1992). See also C'n R Industries of Jacksonville, Inc. ASBCA No. 42,209, 91-2 BCA 23,970 where the contractor was required to reimburse the government for a state fine imposed on its subcontractors.

laws and regulations in effect at the time of award.²⁸ In Shirley Construction, the denial of the contractor's claim for additional testing expenses required by state regulations promulgated after award was upheld,²⁹ and in Holk Development, Inc., the contract requirement to have Maryland asbestos removal license did not limit the application of the "Permits and Responsibilities" clause, when a Virginia licensing requirement was passed during contract performance.³⁰ The fact that the contractor did not have knowledge of the applicable Federal, state or local requirements did not change the result.³¹ In Inman Associates, the "Permits and Responsibilities" clause precluded contractor reimbursement of the additional costs of cleaning a PCB spill to the stricter state levels. It was immaterial that the state policy, consistently enforced for many years, was not a formalized regulation.³²

²⁸Gulf Contracting Inc., ASBCA Nos. 27221 et al. 84-2 BCA 17,472; Norair Engineering Corporation, ENGBCA No. 3375, 73-1 BCA 9955.

²⁹Shirley Construction Corp. 1991 WL 242884 *3, 92-1 BCA 24,563

³⁰Holk Development, Inc. ASBCA No. 40,137, 90-2 BCA 22,852.

³¹R.P.M. Construction Co. 1990 WL 85421 *6, ASBCA No. 36,965, 90-3 BCA 23,051

³²Inman Associates, Inc. 1991 WL 108556 *6, ASBCA Nos. 37869 et al., 91-3 BCA 24,048. According to the board, "The contractual requirement of particular relevance [was] the general mandate in para. 1.3 [of the contract] that the contractor comply with all federal, state and local regulations pertaining to hazardous waste. Generally the state's power is restricted only if there is a clear conflict between state and local regulations and federal policy or the Federal government has assumed exclusive legislative jurisdiction over real property in the state...Rather than conflict, there was agreement between Texas and EPA officials that the stricter standard should apply because of the high water table...Appellant argued that the Texas 'policy' was unenforceable because it was not a formal regulation...We find that the clear, long standing Texas policy, implemented by legislative mandate, has the full force and effect of a published regulation.

R.P.M. Construction highlights the significant risks imposed upon the contractor by the "Permits and Responsibilities" clause. Here, the contractor installed underground storage tanks and was cited by the state after a reported fuel loss and required to install monitoring wells. In addition, the contractor warranted that the tanks would be "leakproof", which under state law required a leakage rate of not greater than .05 gallons per hour. The contractor could get the tank leakage rate down to only .065. After 4 months of extensive analysis, testing, fixing and considerable expense to determine a means to improve the leakage rate, the state increased rate to .088 gallons per hour. The contractor was not entitled to an equitable adjustment for any of its expenses. The board held the contractor's only remedy for the costs for the monitoring wells, as a result of the citation, was by challenging the state citation. Similarly, the costs to bring the tanks into compliance with state leakage standards were not reimbursable because "under the Permits and Responsibilities clause, the contractor had the burden of ascertaining the scope and extent of the local requirements which might impinge upon the work, including the warranties."³³

The risks imposed on the contractor by the "Permits and Responsibility" clause are not without limits. The boards look at the conduct of the government and its compliance with their responsibilities under the contract before denying recovery. In Maitland Bros. Co., the contractor was not required to reimburse the government for costly mitigation measures required by the state, after the contractor filled

³³Id.

wetlands without a permit. The board held that the contractor was entitled to rely on the government markings of the environmentally sensitive areas.³⁴ Similarly, in Alonso & Carus Iron Works, Inc. the Navy was liable for the cost of the fuel spill cleanup due to its unreasonable refusal to allow the contractor to perform a test that would have prevented the spill. Even though the leak was the result of the contractor's negligent workmanship, it would have been discovered and the spill averted by the preliminary test requested by the contractor.³⁵ The "Permits and Responsibilities" clause does not make a contractor an insurer for damage at the site regardless of cause.³⁶ In Morrison-Knudsen & Harbert, the contractor was entitled to reimbursement for the cost of a fuel spill cleanup where the government shared security responsibilities and the government failed to show by a preponderance of the evidence that the contractor's negligence caused the damage.³⁷

II. SUMMARY

There are very limited opportunities in a fixed price contract to recover the

³⁴Maitland Bros. Co. ASBCA Nos. 30089 *et al*, 90-1 BCA 112,366. The contractor was terminated for default and assessed \$138,064.80 for its share of the Federal governments payment to the State of Florida pursuant to a negotiated consent decree. The Board converted the default termination to a termination for convenience (on other grounds) and held that the contractor was not liable for half the cost associated with the consent agreement.

³⁵Alonso & Carus Iron Works, ASBCA No. 38,312, 90-3 BCA 23,148

³⁶Morrison-Knudsen & Harbert, ASBCA No. 43683, 92-2 BCA 24,989.

³⁷*Id.*

costs of additional environmental expenses incurred during contract performance.³⁸ The "Differing Site Conditions" clause and "Changes" clause offer relief only when the conditions causing the increased costs, differ materially from what the contractor could have expected or were the result of a government order or fault. Notwithstanding these clauses, the mandatory "Permits and Responsibility" clause, requiring contractor compliance with all Federal, state, and local laws is a significant limitation on any environmental cost recovery in a fixed price contract.

³⁸If the contractor anticipates the incurrence of significant environmental costs, advanced agreements pursuant to FAR 31.109; a reserve fund, or specific indemnity coverage pursuant to Public Law No. 85-804, 50 U.S.C. §§1431-1435 (1982) may be alternatives. See General Dynamics Corporation, ASBCA No. 39,500, 92-1 BCA 24,657 (1991) on the importance of an advanced agreement to insure recovery of litigation costs related to a fixed price contract, incurred after contract completion.

CHAPTER III

CONTRACTOR RECOVERY OF ENVIRONMENTAL COSTS INCURRED DURING PERFORMANCE OF A COST-TYPE CONTRACT

I. INTRODUCTION

At present, there are no specific provisions governing the allowability of cleanup costs in either CERCLA;¹ Federal procurement statutes;² The Federal Acquisition Regulation (FAR);³ or agency supplements to the FAR.⁴ Consequently, if the contract contains cost reimbursement provisions, a contractor may, as a matter of accounting practice treat CERCLA cleanup costs as "ordinary and necessary" business overhead expenses, which would be reimbursable if otherwise "allowable" under federal procurement regulations.⁵

Allowability of costs in cost-type contracts is governed by general allowability criteria in the FAR 31.201-2 and as a practical matter, guidance from the Defense

¹42 U.S.C.A. §§9601 *et seq.*

²See 10 U.S.C. §2324, "Allowable Costs Under Defense Contracts"

³FAR Part 31, 48 C.F.R. §31.00 *et seq.*

⁴See 48 C.F.R. 2 through 48 C.F.R. 52.

⁵Letter from James F. Hinchman, GAO General Counsel to Honorable John Conyers, Jr. Chairman Committee on Government Operations, House of Representatives, February 3, 1992.

Contract Audit Agency.⁶ Contractors will be reimbursed for environmental cleanup costs, if the costs are reasonable, allocable, in conformance with applicable Cost Accounting Standards (CAS), generally accepted accounting principles or practices, appropriate to the particular circumstances, and not made specifically unallowable by other provisions in the regulations.⁷

A. REASONABLENESS

To recover costs, the contractor's conduct, and the cost in nature and amount, must be reasonable.⁸ The contractor has the burden of showing a cost is reasonable, if on initial review, the contracting officer challenges a specific cost.⁹ According to FAR §31.201-3:

- (a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive

⁶Memorandum for Regional Directors, DCAA Director, Field Detachment, *Audit Guidance on the Allowability of Environmental Costs*. PAD 73.31/92-6, 14 October 1992.

⁷FAR §31.201-2. Relevant costs specifically unallowable include: "Fines and Penalties" (FAR §31.201); Bad Debts (FAR §31.205-3) and some costs related to legal proceedings (FAR §31.205-47)

⁸FAR §31.201-3; and DCAA Audit Guidance, *supra* note 2.

⁹FAR §31.201-3(a). FAC 84-26, 52 Fed. Reg. 19800 (May 27, 1987, effective July 30, 1987) amended the FAR to remove the judicial presumption of reasonableness of incurred costs and put the burden of proof on the contractor.

restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

(b) What is reasonable depends upon a variety of considerations and circumstances, including-

- (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
- (2) Generally accepted sound business practices, arm's length bargaining, and Federal and State laws and regulations;
- (3) The contractor's responsibilities to the government, other customers, the owners of the business, employees, and the public at large; and
- (4) Any significant deviations from the contractor's established practices.

Applying these principles, environmental cleanup costs (including litigation, settlement, and removal and remediation costs for cleanup of the contractor's property and third party sites) incurred while in the performance of a government contract are "reasonable" if the contractor, innocently or non-negligently caused the contamination. The difficult question is reimbursement for costs resulting from failure to exercise due care, willful misconduct or violations of environmental laws.

The DCAA guidance specifically addressing the reasonableness of environmental expenses, includes the following:

Contamination must have occurred despite due care to avoid the contamination, and despite the contractor's compliance with the law.

Increased costs due to contractor delay in taking action after discovery of contamination are not allowable.¹⁰

Cleanup costs that are the result of contractor violation of laws, regulations, orders or permits, or in disregard of warnings for potential contamination would be unreasonable.¹¹

Payments to third parties for health impairment, property damage, or property devaluation near the contamination site due to fault based liabilities, such as those arising from legal theories of tort and trespass, would be unreasonable. In the absence of a specific court finding of tort or trespass by the contractor, the facts of each case should be carefully examined to determine if the contractor payments are none-the-less based on those or other fault based legal theories.¹²

There are no published cases addressing the reasonableness of environmental cleanup costs at contractor owned and operated facilities, however when the Comptroller General (Comptroller), courts, and boards have decided on the reasonableness of "must pay" expenses necessitated by regulation, statute, judicial or administrative order, the focus was on the contractor's conduct relative to the performance required under the contract. Existing interpretations of what is "reasonable" under these circumstances are primarily found in labor cases.

¹⁰DCAA Audit Guidance, *supra*, note 6 at 2.

¹¹*Id.* at 5.

¹²*Id.* Payments to third parties for personal injury or damage to property not owned, occupied or used by the contractor arising out of the performance of the contract, whether or not caused by the negligence of the contractor, are governed by FAR clause 52.228-7, Insurance-Liability to Third Persons, required in most cost-reimbursement contract by FAR §28-311-2. Funds must be available at the time the contingency occurs and, at the time of the final payment, exact or estimated amounts of the liability must be included in the release. FAR §52.216-7(h). If liability is unknown at the time of final payment, the contractor must give notice to the government within six years of the release date or notice of final payment. FAR §52.228-7(c)(2) & (d).

In the early 1940's, the Comptroller confronted issues similar to payment of CERCLA cleanup costs, in determining whether to reimburse defense contractors for labor costs, losses, and expenses incurred in suits by employees under the, then new, Fair Labor Standards Act of 1938.¹³ Like CERCLA, the act was undergoing extensive challenge and interpretation, "rulings of one division of the labor department were inconsistent with the others, and there were numerous disputed questions of fact and applicability. . .The claims often arose from work performed by contractors prior to existing contracts and potentially involved large sums of money."¹⁴ In an early unfair labor practice case where the contractor refused to bargain with the union and terminated three employees because of their union activities, reimbursement for the settlement costs for back wages was disallowed on the basis that the investigation by the National Labor Relations Board (NLRB) disclosed evidence "strongly supporting" the charges.¹⁵ The Comptroller found the costs unreasonable, even though there was no evidence of bad faith or "improper intent", holding that the contractor "knew or should have known, that if any of its employees were discharged because of union activity. . .it would be subject to remedial action by the board."¹⁶ The analysis of "reasonableness" is similar today.

¹³Fair Labor Standards Act of 1938, Title 29, U.S. Code Annotated.

¹⁴Comptroller General Warren to the Secretary of War, December 15, 1943, 23 Comp. Gen. 439, 443.

¹⁵Acting Comptroller General Yates to Major R.W. Bartlett, U.S. Army, December 11, 1943, 22 Comp Gen 349, 355.

¹⁶Id.

The focus is directed to the actions or inactions of the contractor under the prevailing circumstances.¹⁷ According to the board in General Dynamics Corp.¹⁸ "if the [contractor] is to bear the costs claimed, it must do so on the basis that their incurrence was unreasonable in that they were caused by appellant's folly, fault, or dereliction in discharging contractual duties for which [the contractor] was paid a fee."¹⁹

1. Negligence

Contracting officers and auditors, pursuant to the audit guidance, will be looking for "due care" in the handling of hazardous wastes and materials before reimbursing environmental expenses. This includes "due care" of the contractor as an entity and its employees.²⁰ Losses resulting from negligence of the employees

¹⁷Stanley Aviation Corp. ASBCA No. 12292, 68-2 BCA 7081, 32,788 (1968). The board permitted contractor recovery of overhead expenses that the contracting officer disallowed as being "unreasonably high" stating: "The proper way for applying the standard of reasonableness to appellant's overhead costs is to examine them on an item by item basis and exclude from the allowable overhead pools the specific overhead cost items or parts of items found to be unreasonable under the prevailing circumstances. The Government has not cited a single cost item in the overhead pools as having been incurred unnecessarily or in a larger amount than was necessary under the circumstances. On the other hand, the record shows that appellant, acting under the strongest possible economical motivation, namely, the desire to survive, did everything it possibly could to eliminate and reduce its overhead costs."

¹⁸General Dynamics Corp. ASBCA No. 5166, 60-1 BCA 2556 (1960).

¹⁹*Id at* 12,399.

²⁰DCAA Audit Guidance, *supra*, note 6.

which could be attributed to the contractor because of the contractor's practices, systems, or guidance, can preclude recovery.²¹ The Comptroller, deciding on reimbursement of additional costs resulting from theft, noted:

..It appears that the contractor, by its careless and negligent conduct, permitted one of its employees to perpetrate upon it the fraud which resulted in the loss and it now cannot recoup the loss by passing the burden to the government. The contractor set up the system which resulted in the loss and employed the man who is alleged to have committed the theft. It was the plain duty of the contractor to observe due and reasonable diligence to protect itself against such fraud...Since the facts of record fail to show a proper regard for this contractual obligation, it follows that, as between the government and the contractor, the loss justly must fall on the contractor, whose acts and omissions facilitated the fraud and primarily made possible the loss.²²

In Ippoliti, Inc., the contractor failed to document the poor performance of an employee who ultimately prevailed in a wrongful discharge case. Failure to take the reasonable steps necessary to avoid the additional cost resulting in the back pay award, was not considered to be the "actions of a prudent business person" and therefore the costs were unallowable.²³ In contrast, costs resulting from employee negligence were held to be reasonable when the contractor was "not chargeable with any breach of his contractual duties and obligations, including the duty to exercise

²¹Generally, wrongful acts of employees will be a basis for cost disallowance only if the conduct can be attributed to the contractor's management. General Dynamics Corp. ASBCA No. 5166, 60-1 BCA 2556 (1960); Nolan Brothers, Inc. ENGBCA No. 2680, 67-1 BCA 6095 (1967), *aff'd* 194 Ct. Cl. 311, 437 F.2d 1371 (1971); Morton-Thiokol, Inc., ASBCA No. 32629, 90-3 BCA 23,207 (1990).

²²Acting Comptroller General Yates to Major R.W. Bartlett, U.S. Army, December 11, 1943 23 Comp Gen 421, 422.

²³Ippoliti, Inc. February 12, 1990, ASBCA No.35236, 90-2 BCA 114,068.

due diligence to employ . . . trustworthy personnel."²⁴

How far the contracting officers, courts and boards will go in denying environmental cleanup costs on the basis of negligence or that the contractor "knew or should have known" of the effects of a particular business practice is yet to be determined. The DCAA Audit Guidance advises that costs incurred in disregard for warnings of potential contamination and cost that could have been avoided would be unreasonable and thus unallowable.²⁵ The contamination must have occurred despite due care and compliance with the law.²⁶

2. Violations of the Law

There appears to be consensus that costs resulting from violations of law are not reasonable.²⁷ The open questions are "violations", as determined by whom and

²⁴Comptroller General Warren to the Secretary of War, August 16, 1941, 21 Comp Gen 149, 151.

²⁵DCAA Audit Guidance *supra* note 6 at 2.

²⁶*Id.*

²⁷Margaret O. Steinbeck, *Liability of Defense Contractors for Hazardous Waste Cleanup Costs*, 125 Mil. L. Rev. 55 (July 1989); John F. Seymour, *Liability of Government Contractors For Environmental Damage*, 21 Public Contracts Law Journal 482, 520 (Summer 1992); American Bar Association, Section of Public Contract Law, Letter to Colonel Nancy L. Ladd, Director Defense Acquisition Regulations System, *Draft Environmental Cost Principle*, CAAC Case 90-101, DAR Case 91-56, August 24, 1992. It is the Bar Association's position that a violation of the law should not be deemed to have occurred unless a final and unappealable judicial or administrative order has been entered in an enforcement proceeding by a court or administrative agency having jurisdiction over environmental matters.

under what circumstances? These questions are not answered in the FAR and no courts have resolved them for violations of environmental laws. There are some guiding principles as they apply to the reasonableness of costs surrounding labor disputes, however the direct application to environmental "violations" has yet to be determined. The Supreme Court dealing with the reasonableness of labor costs for regulated utilities held that costs resulting from discrimination, unfair labor practices, or back pay awards resulting from an order from the Labor Relations Board were not reasonable when the costs have been "demonstrably quantified by judicial decree or final action of an administrative agency charged with consideration of such matters."²⁸ The Board of Contract Appeals in Joint Action, applying that principle to contractors regarding federal agency decisions, held costs for labor violations were "demonstrably quantified" when the agency making the decision had the authority to make conclusive findings of fact and the contractor had a right to appeal.²⁹ In Joint Action, the contractor sought reimbursement of attorney's fees and settlement costs of a years' wages, after the Office of Federal Contract Compliance Programs (OFCCP) issued a "Notification of Results of Investigation" that the employee "had been terminated in a impermissibly discriminatory manner."³⁰ The contractor had a right to appeal, but elected to settle, which left the question "what is to be done

²⁸NAACP v. The Federal Power Commission (FPC) 425 U.S. 662, 668 (1976); 96 S.Ct. 1806; 48 L. Ed 2nd 284 (May 19, 1976).

²⁹Joint Action in Community Service, Inc. LBCA No. 83-BCA-18, *Reconsideration of Appeal*, 88-3 BCA 20,949, 105,866.

³⁰*Id.*

when the merits of the complaint have not been determined?"³¹ The board stated:

For the Department of Labor to reimburse the costs of such a "settlement" would remove all motivation for any contractor to bother with any concern to observe the Federal employee protection provisions with respect to which the Secretary of Labor has been given responsibility...by providing in effect that payment in full by the contractor for any violations that were charged and were confirmed upon investigation by the OFCCP would ultimately be made good by the same Federal Government that had imposed the requirements in the first place. To hold in this way that the Government is for all practical purposes an insurer against enforcement of its own regulations would be altogether irrational.³²

Similarly, In the Matter of Westinghouse Learning Corporation, additional costs resulting from a finding of violation by the National Labor Relations Board were held unreasonable. The Board of Contract Appeals reviewed all the facts and circumstances of the case and held: "the [contractor's] illegal discharge of the original counselors and the increased costs occasioned thereby, resulted in no tangible benefit to the Government nor were such actions incidental to the proper performance of the contract."³³

Findings of violations by state courts do not necessarily preclude reimbursement however, costs will be found unreasonable if the contractor fails to show (a) the state judgment was erroneous, (b) that it had not breached the

³¹Joint Action in Community Service, Inc. LBCA No. 83-BCA-18, 87-1 BCA 19,506, 98,601.

³²*Id.* at 98,605.

³³In the Matter of Westinghouse Learning Corporation Atterbury Job Corps Center, March 31, 1976, 76-1 BCA 11,795 (CCH) 56,286.

government contract, or (c) that the acts were committed by the contractor in the faithful performance of the government contract.³⁴

The stated principle that costs are unallowable when there is a finding of a violation by the requisite authority from which the contractor had the right to appeal, does not obviate the need to examine the contractor's conduct under the circumstances. There are no hard and fast rules for determining reasonableness. Examining the contractor's conduct in Joint Action, and attempting to distinguish that case from a long line of cases finding labor dispute costs reasonable, the board recognized the "situation was a close one".³⁵ Generally, the government has not been successful in disallowing costs on the basis of unreasonableness when the decision to incur the cost involves the exercise of sound business judgment.³⁶ The Comptroller, courts and boards have consistently looked behind the violation determination and made a "de novo" decision on whether under the circumstances, the contractor's conduct was reasonable. In Boeing Airplane Company, even though the contractor was found by the Labor Relations Board to have illegally discharged

³⁴Dade Brothers Inc. v. United States, 325 F2d 239 (Ct.C., 1963), *cert. denied*, 377 U.S. 916, 84 S.Ct. 1181, 12 L.Ed.2d 186 (1964)

³⁵Rehearing of Joint Action in Community Service, (1988) 88-3 BCA 20,949, 105,867 *distinguishing* Hirsch Tyler Company, 76-2 BCA 12,057; Machine Products Co. Inc. 58-1 BCA 1704; Ravenna Arsenal, Inc. 74-2 BCA 10,937; C.I.R. v. Tellier, 383 U.S. 687 (1966); Hayes International Corp. 75-1 BCA 11076 (ASBCA); John Doe Company, Inc. 80-2 BCA 14,620 (ASBCA); General Dynamics Corp. 82-1 BCA 15,616 (ASBCA); Hewitt Contracting Co., 83-2 BCA 16,816 (ENGBCA); *cf.* Olin Corporation, 72-2 BCA 9539, 44,440 (1972).

³⁶Cibinic & Nash, Cost Reimbursement Contracting, *supra* note 13 at 5-98. *See cases cited therein.*

three employees, the comptroller found the violations excusable and the court ordered back pay reimbursable, noting the relative few errors in judgment on the part of the contractor involved in such serious labor difficulties.³⁷ In Hirsch Tyler Co., the contractor entered into a "Stipulated Judgment" in District Court, to resolve the plaintiff's claim that the contractor "filled a position with a less qualified male and refused to consider her solely because she was a female". The board noted that there was no evidence that she had applied for the position and that the judge "had been inclined to dismiss the complaint". The board concluded that the stipulated judgment reflected the District Court's finding of only a "technical violation". Because the judgment and the record did not provide a "firm basis to conclude" either intentional discrimination or that the contractor acted in bad faith, the costs were reasonable and allowable.³⁸ See also, Machine Products, costs resulting from a grievance procedure allowed,³⁹ and Ravenna Arsenal, Inc. where two prospective employees sued the contractor for discrimination alleging, among other things, the company height requirements had the effect of excluding a disproportionate number of women from employment. The contractor stipulated to a conciliation agreement to pay \$3,500 in settlement, which the Comptroller found reasonable. The board, allowing the costs, found that the contractor made a "prudent decision which served

³⁷Unpublished opinion of the Comptroller General, B-131962 (1957).

³⁸Hirsch Tyler Company, ASBCA No. 20962, August 23, 1976, 76-2 BCA 12,075 (CCH) 57,981, 57,985.

³⁹Machine Products, ASBCA No. 4577, 58-1 BCA 1704.

not only its own best interests but that of the Government".⁴⁰

CERCLA liability, unlike the liability in the cases cited above, generally does not depend on contractor wrongdoing. Contractors are liable for cleanup costs under CERCLA by virtue of their status as owners or prior owners of contaminated property, generators or transporters of hazardous substances.⁴¹ Under the strict liability standards of CERCLA, the contractor is liable for cleanup costs even though its disposal practices were consistent with industry standards at the time. Accordingly, these costs would be reasonable, if the hazardous or damaging nature of the waste or materials was unknown at the time the contract was negotiated and performed, and the contractor was operating in conformance with the law and generally accepted sound business practices.

However, just because CERCLA is a "no fault" statute, does not mean that the contamination was not the result of improper disposal practices and past violations of Federal, state or local law. The "reasonableness" of incurring these costs depends on the contractor's compliance with the existing law and the law at the time the contamination occurred. This requires an evaluation of the contractor's present conduct, its conduct at the time of the contamination, the finality of and the reasoning behind any violation determination, and business practices at the time. This will not be a straight forward matter. Claimed costs for reimbursement can be

⁴⁰Appeal of Ravenna Arsenal, Inc. October 31, 1974 ASBCA No. 17802, 74-2 BCA 10,937 (CCH) 52,154, 52,061.

⁴¹42 U.S.C.A. 9607(a)

the result of CERCLA reporting violations, failure to comply with cleanup orders, or violations of other environmental statutes governing the handling of hazardous substances.⁴² The Solid Waste Disposal Act/RCRA (42 U.S.C.A. 1251 *et seq*), Clean Air Act (42 U.S.C.A. 7402 *et seq*) and the Clean Water Act (33 U.S.C.A. 1251 *et seq*) are just a few of the relevant federal statutes, to add to a long list of state environmental statutes. Each of these statutes has a range of enforcement options to include the informal: verbal or written notification of violations (NOV); and the formal: administrative orders (orders requiring remedial action or to refrain from specified behavior); administrative penalties; injunctive relief; and court imposed civil and criminal penalties.⁴³ States have similar enforcement options, to include:

⁴²CERCLA §113, 42 U.S.C.A. 9613. See U.S. Automation Components, et al. (D. New Jersey) where Region II issued a unilateral order to cooperate to PRPs, who failed to participate in a 1985 settlement. Upon their failure to comply, the EPA sought civil penalties and treble damages; U.S. v. Environmental Service Group, et al. (W.D. New York) company fined \$40,000 for violation of EPA's administrative cleanup order; U.S. V. Frola, et al. (D. New Jersey) failure to comply with administrative orders or the consent agreement, company liable for costs, civil penalties and treble damages which amount to more than 10 times what they would have paid had they chosen to participate in the original settlement; U.S v. Grumman, St. Augustine, Florida violated RCRA Land Disposal Restrictions by failing to identify restricted waste streams and give required notice and information to the disposal facility; U.S v. MTD Products Inc. and Columbia Manufacturing Co. Inc., 29 violations of federal and state RCRA and Clean Water Act violations resulted in soil and ground water contamination. United States Environmental Protection Agency, "Enforcement Accomplishment Report FY 1991", 300-R92-008, April 1992 at 4-11 - 4-38.

⁴³Enforcement provisions of the major media statutes include: Clean Air Act §113; Clean Water Act §309, 33 U.S.C. §1319; RCRA §3008, 42 U.S.C. §6928; CERCLA §106, 42 U.S.C. §9606. See also, Arnold Reitze, Professor of Environmental Law, The George Washington University, *Goals of Enforcement*, p. 7-20, February 9, 1992.

citations and notices of violation; "cease and desist" orders; permit suspension or revocation; remedial actions; injunctions to enforce permit conditions; civil and criminal enforcement.⁴⁴

Even if there is a violation of environmental law, the contracting officer will have to look further into the law, the circumstances of the violation, and its connection to the contamination, before finding the cleanup costs unreasonable. However, agency "enforcement" actions (such as those by EPA or state environmental regulating agencies) are indications of unreasonable conduct and should trigger "the challenge" which would then place the burden on the contractor to show the reasonableness of the costs.⁴⁵

The following highlights some of the complexities in this evaluation. Generally informal enforcement options are unilateral agency actions that are advisory in nature such as a notice of noncompliance, Notice of Violation (NOV) or a warning letter, which a contractor cannot challenge in court.⁴⁶ In these actions, EPA advises the manager of a facility what violation was found, what should be done to correct

⁴⁴Reitze, *Goals of Enforcement*, *supra*, note 36 at 20.

⁴⁵FAR §31.201-3(a) provides: "If an initial review of the facts results in a challenge of a specific cost by the contracting officer... the burden of proof shall be upon the contractor to establish that such cost is reasonable.

⁴⁶United States Environmental Protection Agency, Office of Enforcement (LE-133) "Environmental Enforcement, A Citizens Guide" March 1990. Informal responses carry no penalty or power to compel action, but if they are ignored, they can lead to more severe actions.

it, and by what date.⁴⁷ They are not final actions under the Administrative Procedures Act.⁴⁸ Appeals and court challenges are provided for only when the agency takes formal administrative, civil or criminal action.⁴⁹ Given the limited rights to appeal a Notice of Violation (NOV), should a NOV be the sole basis upon which to deny reimbursement of cleanup costs? Formal administrative orders and penalty assessments afford a contractor the right of appeal, however they can be imposed for "one-time" failures to monitor, submit timely reports, or other technical violations. Should "minor" or "technical" violations of the law preclude recovery of cleanup costs under the contract? What about violations of stringent Federal, state or local standards that are technologically infeasible? What is the impact of government specifications or actions of the contracting officer requiring or knowingly acquiescing in the contractor's hazardous waste treatment and disposal practices? There are no clear answers. The consistent guidance from the contract case law is that the contracting officer must look behind the agency's regulatory actions and evaluate all the facts and circumstances to determine the reasonableness of the contractor's conduct.

Because of the range of enforcement options, the unilateral nature of many, and the nature of the conduct regulated, Federal and state environmental regulatory actions should only be evidence of negligence and violations of the law, and not

⁴⁷Id.

⁴⁸5 U.S.C.A. §701(a)

⁴⁹See 42 U.S.C. §6928, SWDA §3008 for formal enforcement options for RCRA violations, and 42 U.S.C. 9606 for CERCLA violations.

necessarily dispositive. In some respects, this was how the Aerojet case was handled.⁵⁰ When Aerojet General Corporation filed a claim for reimbursement of cleanup costs for its Rancho Cordova site near Sacramento California, the contracting officer denied Aerojet's claim after discovering that they had been discharging hazardous materials in violation of their state permit and had been found in violation by the State Water Resources Board.⁵¹ The company appealed the contracting officer's decision on the basis there was no violation of the state permit because its disposal practices were in compliance with government and industry practices, were known and approved by the state, and were not prohibited by the permit. One of the bases upon which the government settled the case and agreed to partially reimburse the contractor for cleanup costs was that the state discharge permits were not specific enough to be considered strong evidence of negligence.⁵² In addition, the State Water Board order, allegedly violated, was a 1952 order that

⁵⁰GAO Report to Congressional Requesters, *Environmental Cleanup, Observations on Consistency of Reimbursements to DOD Contractors.*, GAO/NSIAD-93-77, October 1992.

⁵¹The GAO notes one example, "one permit issued in 1952 specifically prohibited discharges of hazardous materials, including trichlorethylene, at the Aerojet facility in a manner that would result in contamination of ground water or the American river.

⁵²*Id.* The other reasons for settlement included: the government was a potential contributor, the indemnification clause could be interpreted to include groundwater contamination and some of the DOD contracts required the use of the chemicals contributing to the contamination.

did not prohibit the contractor's actions that ultimately caused the contamination.⁵³

In the case of Boeing Company and the Seattle Waste Disposal Sites, the contracting officer recognized Boeing's cleanup costs for forward pricing and interim billing purposes based on a preliminary finding that the contractor did not violate Federal, state, or local pollution laws when it used the sites and Boeing incurred the cleanup costs as a result of subsequent, more stringent environmental laws.⁵⁴

According to the General Accounting Office (GAO),

...to determine if Boeing violated then-existing laws and regulations, the contracting officer relied on information developed during extensive discussions with Boeing and information gathered by DCAA. This included (1) a statement from Boeing that it had not violated then-existing laws and regulations; (2) a report of the special master appointed by the court to oversee the project [finding] no evidence of wrongdoing...(3) the 1986 consent decree...which stated that the costs were not the result of fines or penalties.⁵⁵

The GAO suggests that the contracting officer is reconsidering the allowability of a portion of the costs on the basis of evidence that Boeing "expected or intended" pollution to occur at the site in 1971, but continued to use the site until 1977.⁵⁶

⁵³Letter from Roger I. Ramseier, President Gen Corp/Aerojet to Mr. Paul E. Steiger, Managing Editor, The Wall Street Journal, September 16, 1992, in response to the Journal's August 31st article by Bill Richards and Andy Pasztor "Why Pollution Costs of Defense Contractors Get Paid by Taxpayers".

⁵⁴GAO Report to Congressional Requesters, *Environmental Cleanup, Observations on Consistency of Reimbursement to DOD Contractors*, GAO/NSLAD-93-77, October 1992, Appendix II at 26.

⁵⁵Id.

⁵⁶Id. See also Letter from Eleanor R. Spector, Director, Defense Procurement, Office of the Secretary of Defense to Brad Hathaway, Associate Director for Air Force Issues, National Security and International Affairs Division, U.S. General

3. Effect of Settlement or Other Disposition

Whether a contractor settles or litigates a case to final disposition does not determine the reasonableness or allowability of cleanup costs, unless the contractor is fined or assessed penalties.⁵⁷ According to the Board of Contract Appeals in Hirsch:⁵⁸

[A] contractor's failure to prevail in the litigation is not dispositive of the issue of allowability. A determination of allowability must be made on a case-by-case basis and will be controlled by considerations of the reasonableness of the costs in nature and amount and whether their reimbursement is otherwise prohibited by some exclusionary cost principle. Factors to be considered include, but are not limited to, the facts and circumstances giving rise to the judgment or award and the punitive or compensatory nature of the ultimate award.⁵⁹

A contractor cannot settle a case and get reimbursed for the costs if the underlying conduct is unreasonable.⁶⁰ It is not the terms of the settlement or

Accounting Office, January 5, 1993 presenting DOD's response to GAO/NSIAD-93-77. In contrast to Aerojet, no final overhead rate proposals containing environmental restoration costs have been submitted by Boeing and therefore the contracting officer has not yet conducted the detailed fact-finding necessary to make final allowability determinations.

⁵⁷See also §FAR 31.205-47 for rules governing the recovery of legal costs upon settlement of a government proceeding.

⁵⁸Hirsch Tyler Company, ASBCA No.20962, August 23, 1976, 76-2 BCA 12,075 (CCH) 57,981.

⁵⁹*Id* at 57,985.

⁶⁰In Joint Action in Community Service, 99-3 BCA at 105,867 where the underlying facts indicated unreasonable conduct, in the discharge of an employee under the Fair Labor Standards Act, the Board disallowed the settlement costs, stating: "... if the contractor, who is thus in a position to require a formal adjudication

method of assessment,⁶¹ but the facts and circumstances of the case that are critical.⁶²

This is particularly important in CERCLA environmental cost reimbursement cases, because most cases are "settled" administratively, liability being defined by a formal consent decree, approved by the Federal District court.⁶³ These consent decrees are of limited value in determining the reasonableness of the contractor's actions that triggered the cleanup costs, because liability is not dependant on fault.⁶⁴ As a general rule, neither the EPA nor the state make any effort to determine

of the validity of the charges against it, chooses instead to settle its way out of the dispute, the merits of the matter will never be determined, and the Government would be in the anomalous position of acting as insurer protecting its contractors from any liability for violating the very standards that the selfsame government imposed upon them."

⁶¹CERCLA gives the EPA numerous mechanisms to recover costs and assess penalties. Using the "Superfund", the EPA can clean up the contamination and assess the contractor; seek injunctive relief to require the responsible parties to clean up the site; issue an administrative order requiring the responsible parties to clean up the site; or enter into an agreement with responsible parties to perform any necessary response action, 42 U.S.C.A §9604(a). The characterization of the remedy in terms of "restitution" or "damages" is not dispositive of the allowability of the costs. Hirsch Tyler, ASBCA No. 20962, August 23, 1976, 76-2 BCA 12,075 at 57,985.

⁶²Comptroller General Warren to Lt. Col. W. Gritz, U.S. Army, 22 Comp Gen 349, B-28322 (1949) in one of the first decision on this issue stated: "whether or not a [contractor] has failed to discharge its obligations...is a question of fact to be ascertained from the record in evidence presented to the Board..."

⁶³42 U.S.C.A. §9607; 42 U.S.C.A. 9622(d)(1)(a). *See also* United States Environmental Protection Agency, Enforcement Accomplishments Report, FY 1992, "Superfund Enforcement" 6-5, Office of Enforcement (LE-133), EPA 230-R-93001, April 1993.

⁶⁴42 U.S.C.A. §9607

negligence or violation of law in finding CERCLA liability.⁶⁵ Their focus is on securing an agreement to insure responsible parties cleanup the property, rather than on identifying any wrongdoing. In fact, in many cases the consent decree states specifically that the payments are not penalties or monetary sanctions. This practice is typified in the Aerojet case. In 1979, the California Attorney General filed suit against Aerojet for violation of environmental laws, but subsequently agreed not to bring suit if the company entered into a consent decree to cleanup the contamination and pay monetary claims to the state for environmental damage. The consent decree stated that none of Aerojet's payments under the decree were fines or penalties.⁶⁶

The contracting officer must look beyond the terms of the settlement to determine whether reimbursement is proper. A close review of the facts of the case may establish that the contamination occurred as a result of negligence or violations of other environmental laws.⁶⁷ If the underlying facts indicate such unreasonable conduct, notwithstanding the terms of the settlement agreement, the costs are not reimbursable.⁶⁸

⁶⁵GAO Report to Congressional Requesters, *Environmental Cleanup, Observations on Consistency of Reimbursements to DOD Contractors*, GAO/NSIAD-93-77, October 1992, p. 19, 26.

⁶⁶*Id.* at 19.

⁶⁷DCAA Audit Guidance, *supra*, note 6 at 5 provides that because there is no requirement that the contractor be guilty of a violation to enforce contractor payment of cleanup costs, the "contractors should be requested to provide documents sufficient to allow a determination as to how the contamination occurred".

⁶⁸*Id.*

4. Fines or Penalties

Fines and penalties are not only indicators of unreasonable conduct but are also expressly unallowable under FAR 31.205-15, which provides:

Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, federal, state, local, or foreign laws and regulations, are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

Fines assessed for "merely technical violations"⁶⁹ and penalties assessed, notwithstanding reasonable efforts to comply are not reimbursable.⁷⁰ However, just because the assessment is called a penalty, does not automatically require disallowance. The Board of Contracts Appeals looks behind the decision resulting in assessment, and reexamines the contractor's conduct and the extent of fault. In The Appeal of McDonnell Douglas Corporation, the board allowed reimbursement of costs in a workman's compensation case after a state court finding of misconduct. Under state law, the award was characterized as being "in the nature of a penalty", however the Comptroller allowed reimbursement, finding "no violation of law or

⁶⁹Appeal of Columbia University, ASBCA No. 3862, 57-1 BCA 1340 (1957) Reimbursement disallowed on fines imposed for failure to get proper approvals from the Immigration and Naturalization Service before dismissing alien crew members.

⁷⁰In the Matter of Metropolitan Denver Construction Opportunity Policy Committee, 74-2 BCA (CCH) 10749 (1973) reimbursement of the cost of a penalty for late payment of taxes, disallowed.

willful misconduct".⁷¹

Even though the incurrence of cleanup costs to remedy contamination resulting from past activities is, in a sense, a legal obligation and generally not the result of fines or penalties, CERCLA actions are often intertwined with the imposition of fines and penalties for violations of the other environmental statutes. Unless these fines and penalties were incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer, they are unallowable.⁷² In addition, the imposition of fines and penalties resulting from CERCLA violations or violations of other environmental statutes can be strong evidence of unreasonable conduct which also would make the cleanup costs, legal and other professional costs unallowable.⁷³

5. Legal Costs

To determine the allowability of legal expenses, the contracting officer must look at the nature and the result of the proceeding, the reasonableness of the underlying conduct, the terms of the contract, and the involvement of the contracting officer. Costs incurred in connection with defense or prosecution of claims or appeals

⁷¹In the Appeal of McDonnell Douglas Corporation, NASA BCA No. 865-28, 68-1 BCA 7021 (1968). *See also* Joint Action in Community Service (1986) 87-1 BCA at 98,603.

⁷²FAR §31.205-15

⁷³FAR §31.205-47; FAR §31.205-33.

against the Federal government are unallowable.⁷⁴ If the proceeding is brought by a third party, FAR §31.205-33 "Professional and Consultant Services Costs" apply to retained counsel and contracted legal services and the general principles of allowability govern the reimbursement of costs for in-house legal services. Proceedings brought by the government, are governed by FAR §31.205-47.

a. Proceedings brought by third parties

Cost of professional and consultant services, including legal services are generally allowable under FAR §31.205-33 when the costs are well-documented, necessary and reasonable in nature and scope, considering the contractor's capability in the particular area, and not made unallowable by any other cost principle.⁷⁵ Similarly, the costs of in-house legal services are allowable if reasonable, allocable, and in conformity with CAS and generally accepted accounting principles.⁷⁶ Reimbursement is generally not contingent on the outcome.⁷⁷

According to the Board of Contract Appeals in Hirsch Tyler, legal fees and the costs of satisfying an award or judgment are separate and distinct and "the

⁷⁴FAR §31.205-47(f)(1). Claim, as used in this subpart, means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. (FAR §33.201)

⁷⁵FAR §31.205-33(a) & (b).

⁷⁶FAR §31.201-2.

⁷⁷*But see, Joint Action in Community Service*, LBCA No. 83-BCA-18, 87-1 BCA 19,506

distinction between these types of costs must be observed in determining their allowability."⁷⁸ The board noted:

an ordinarily prudent person in the conduct of competitive business is often obliged to defend lawsuits brought by third parties some of which are frivolous and others of which have merit. In either event, the restraints or requirements imposed by generally accepted sound business practices dictate that, except under the most extra ordinary circumstances, a prudent businessman would incur legal expenses to defend a litigation and that such expenses are of the type generally recognized as ordinary and necessary for the conduct of a competitive business.⁷⁹

The board held that legal expenses incurred in defending a civil litigation brought by a third party, regardless of the outcome are 'prima facie' reasonable and allowable, unless shown to have been incurred unreasonably or reimbursement is expressly prohibited by an exclusionary cost principle.⁸⁰ See also Hayes International Corporation where, even though the Equal Employment Opportunity Commission (EEOC) found evidence of discrimination, legal fees were reimbursed because there was no finding of wilful or malicious conduct.⁸¹

⁷⁸Hirsch Tyler Company, ASBC No. 20962, 76-2 BCA 12,075 (CCH) 57,981, 57,985.

⁷⁹Id.

⁸⁰Id.

⁸¹Appeal of Hayes International Corporation, ASBCA No. 18447, 75-1 BCA 11,076 (CCH) 52,721, 52,727. *But see*, Joint Action in Community Service, Inc. LBCA No. 83-BCA-18, 87-1 BCA 19505 (1986) where the board found legal costs were unreasonably incurred when the contractor found in violation of a federal statute.

The case law and the FAR allow reimbursement for legal costs, notwithstanding the allowability of the costs of satisfying an award or judgment. Exactly how this will be applied to environmental litigation is unclear. The DCAA audit guidance advises that payments to third parties (property damage, or property devaluation for residents or property owners near a contaminated site) due to fault based liabilities arising from legal theories of tort and trespass "would be unreasonable in nature for payment on a government contract."⁸² The courts and boards have not decided the issue of allowability of legal fees under these circumstances, however if these expenses are reasonable and allocable to the government contract, there is no basis for denying reimbursement.⁸³ With regard to Potentially Responsible Parties (PRP), DCAA advises that allowable environmental costs should only include the contractor's share of the cleanup costs based on the actual percentage of the contamination attributable to the contractor, and any costs, including legal fees, the contractor cannot collect pursuant to their contribution and subrogation rights, are unallowable, because they are in their essential nature "bad debts".⁸⁴

⁸²DCAA Audit Guidance, *supra*, note 6 at 5.

⁸³See FAR §52.228 "Insurance-Third Party Liability" and Part B, this chapter, "Allocability".

⁸⁴*Id.* at 4. The Audit guidance cites FAR §31.205-3 "Bad Debts" and FAR §31.204(c) "Application of Principles and Procedures". FAR §31.205-3 disallows reimbursement for bad debts and related expenses, including estimated losses arising from uncollectible claims. It provides: "Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs, and legal costs are unallowable." FAR § 31.204(c) provides in relevant part: "Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this

b. Proceedings brought by the government.

FAR §31.205-47 disallows reimbursement for legal fees in civil or administrative proceedings when they result in monetary penalties or the underlying conduct or other disposition was such that it could have lead to a monetary penalty.⁸⁵ Specifically, FAR §31.205-47(b) in relevant part, provides:

Costs incurred in connection with any proceeding brought by a Federal, state, local or foreign government for violation of, or a failure to comply with, law or regulation by the contractor (including its agents or employees) are unallowable if the result is . . . (1) In a criminal proceeding, a conviction; (2) In a civil or administrative proceeding, . . . imposition of a monetary penalty. . . (4) Disposition of the matter by consent or compromise if the proceeding could have led to any of the outcomes listed in (1) and (2)...

However, notwithstanding the above, legal costs may be allowable if the contracting officer determines that the costs were incurred as a direct result of a specific term or condition of the contract or were in compliance with the written direction of the contracting officer.⁸⁷

subpart and the treatment of similar or related selected items."

⁸⁵FAR §31.205-47. The "Proceedings" cost principle, as amended, became effective on January 22, 1991.

⁸⁶A penalty does not include a payment to make a unit of government whole for damages or the interest accrued on the damages. A penalty is in the nature of a punitive award. DCAA Audit Manual.

⁸⁷FAR §205-47(d)

The overall approach of this cost principle is to render unallowable, the *costs* of certain *proceedings*.⁸⁸ Costs covered are (1) administrative and clerical expenses; (2) legal services costs, whether performed by in-house or retained counsel, (3) costs of accountants, and (4) the costs of employees, officers, and directors.⁸⁹ They include:

All costs which would not have been incurred but for the proceeding. This includes costs incurred before, during and after the proceeding. The concept of "before the proceeding" should be interpreted to cover the following: (1) when a contractor anticipates and begins to prepare for a proceeding before it has been officially notified that a government has initiated a proceeding and (2) when the contractor is conducting its own investigation or inquiry preparatory to initiating a proceeding.⁹⁰

What kind of governmental action constitutes a proceeding is not precisely defined in the FAR, however it is clear that it is dependant primarily on the outcome. A working definition in the DCAA Contract Audit Agency Manual states:

A proceeding includes any investigation, administrative process, inquiry, hearing, or trial conducted by a local, state, Federal, or foreign governmental unit and appeals from such proceedings. Note that for the purposes of this cost principle, the term proceeding includes, but is not limited to, those related to actions which in nature are criminal, noncriminal, fraud, non-fraud, contract-related, or non-contract-related. The definition is very broad.⁹¹

⁸⁸Ronald Schechter & Maureen T. Kelly, *The Proceedings Cost Principle*, CP & A Report 15, 19 (March 1991)

⁸⁹FAR §31.205-47(a)

⁹⁰Department of Defense, Defense Contract Audit Agency, DCAA Contract Audit Manual, DCAAM 7640.1, Volume 1, §7-1918.3, July 1992.

⁹¹*Id at* §7-1918.2(b)

The cleanup of a contaminated site under CERCLA is an administrative process which frequently involves a combination of investigations,⁹² inquiries,⁹³ hearings,⁹⁴ and trials⁹⁵. However, it is still an open question on what, if any part of the CERCLA cleanup process will be considered a "proceeding" and what legal costs will be allowed.

The primary goal of CERCLA is to get the contaminated site promptly cleaned up and paid for by those parties responsible for the contamination, not to ferret out violators and assess penalties. Nonetheless, the EPA has the power to take administrative and judicial actions to penalize recalcitrants, if in the course of the CERCLA cleanup process, responsible parties are not cooperating, not in compliance

⁹²CERCLA §104(b) authorizes the EPA "to undertake such investigations, monitoring, surveys, testing, and other information gathering as deemed necessary or appropriate to identify the existence and extent of the release or threat thereof, ..." CERCLA §104(e)(3) allows the EPA to enter property to inspect and obtain samples of suspected hazardous substances, either after consent of the property owner, or if consent is refused, the EPA may issue an order, enforced by judicial action. The court may assess a civil penalty not to exceed \$25,000 for each day of noncompliance against any person who unreasonably fails to comply.

⁹³See Environmental Protection Agency, Superfund Program; Notice Letter, Negotiations and Information Exchange, 53 Fed. Reg. 5298,5306-7 (1988); CERCLA §104(e)(2) authorizes the EPA to require any person who has or may have information relevant to the contamination and cleanup to furnish relevant information and documents. In addition, that person must grant the EPA access to inspect and copy all documents or records relating to such matters.

⁹⁴See 42 U.S.C. §9622 "Settlements"; §9622(h)(2); 40 C.F.R. §304.11(a) "Use of Arbitration"; 42 U.S.C.A. 9607(L)(1),(4) gives the EPA the authority to impose liens, enforced by an action "in rem" in the appropriate Federal district court.

⁹⁵See 42 U.S.C.A. §9613 "Civil Proceedings".

with the law, or in violation of the terms of a settlement agreement.⁹⁶ Whether legal costs will be "allowable" will depend on the purpose and the outcome of the "proceedings" initiated in the course of the CERCLA process.

For example, the EPA under CERCLA §104(d) is authorized to require information and documents regarding a potential CERCLA site to determine the appropriate response action or to enforce CERCLA.⁹⁷ Failure to comply fully with such a request, could result in civil penalties of up to \$25,000 per day, if the failure to respond is unreasonable.⁹⁸ The investigation or inquiry initiated to secure this information would be a "proceeding" under the broad terms of the FAR, however the allowability of legal costs would depend on compliance with the request, since failure to comply could result in the imposition of a monetary penalty. If the contractor's actions in failing to provide the requested information or documents were unreasonable, the legal costs would be unallowable if a penalty was imposed or the

⁹⁶See United States Environmental Protection Agency, Enforcement Accomplishments Report, FY 1992, Office of Enforcement (LE-133), EPA 230-R-93-001, April 1993, *noting*: U.S. v. Asarco, Inc. (D. Kan.) The \$453,750 penalty in this case represented the largest penalty ever for noncompliance with a CERCLA information request; U.S. v. Allied Signal, et al., (N.D.N.Y.) Clothier Disposal Site, East Granby, New York: The settlement, with 24 generator PRPs, provided for \$2.525 million in past costs, plus a \$25,000 penalty paid by one of the defendants for noncompliance with a removal order under CERCLA §106; U.S. v. Automation Components et al. The EPA issued four orders to PRPs to cooperate in performing a removal action, then brought an action against the viable noncomplying parties for penalties and enforcement costs against non-participants, which resulted in \$425,000 in penalties for noncooperation. *See also*, cases cited, *supra*, note 42.

⁹⁷42 U.S.C.A. §9604(e)(1).

⁹⁸42 U.S.C.A. §9604(e)(5)(b)(ii).

matter was disposed of by settlement in a consent decree.⁹⁹

Similarly, the EPA can issue Unilateral Administrative Orders (UAO) "as may be necessary to protect public health and welfare and the environment" when the EPA "determines that there may be an imminent and substantial endangerment to the public health or welfare or the environment because of an actual or threatened release of a hazardous substance from a facility"¹⁰⁰ UAOs include findings of fact, conclusions of law, and administrative determinations.¹⁰¹ The PRP's are afforded an opportunity to participate in a nonevidentiary conference with the EPA, with the scope limited to "issues of implementation of the response actions required by the order and the extent to which the respondent intends to comply with the order."¹⁰² Failure to comply with the order could result in a penalty of \$25,000 per day for the duration of the noncompliance.¹⁰³ If EPA takes the required response actions, a cost recovery lawsuit in Federal district court can result in punitive damages of up to three times the response costs incurred by the Superfund.¹⁰⁴ These

⁹⁹FAR §31.205-47(b).

¹⁰⁰42 U.S.C.A. §9606(a)

¹⁰¹Marie M. Fogelman, Hazardous Waste Cleanup, Liability and Litigation, §4.6 "Section 106(a) Unilateral Administrative Orders", (1st ed. 1992).

¹⁰²*Id at* 83. Liability issues or reasons for issuance of the order are outside the scope of the conference.

¹⁰³42 U.S.C.A. §9606(b).

¹⁰⁴42 U.S.C.A. §9607(c)(3). *See also* U.S. v McGraw-Edison Co. et. al., (W.D.N.Y) Olean Well Field Superfund Site, Olean, New York, *discussed in* EPA Enforcement Accomplishment Report *supra* note 96 at 3-49, where the company agreed to pay the EPA \$700,000 in past costs and a \$50,000 civil penalty for failure to comply with a

administrative actions are "proceedings", however it is not until judicial or administrative enforcement actions are taken to enforce the UAO or recover the EPA's response costs, that the "allowability" of legal costs becomes an issue. Legal costs will be allowed unless the "proceedings" result in a monetary penalty, or there is a settlement in lieu of a penalty.

Without case law or further regulatory guidance on the question of the allowability of legal costs in CERCLA cases, each "proceeding" in the CERCLA process must be evaluated to determine the allowability of these costs. To the extent the "proceeding" does not involve a question of compliance with the law, which could result in monetary penalties, the CERCLA action would not be the type of "proceeding" that would preclude reimbursement for legal fees, if otherwise reasonable.

B. ALLOCABILITY

To be reimbursable, environmental costs must be allocable to a government contract, as well as reasonable. The fundamental precepts of allocability are that the contractor's costs of doing business be charged to the government on the basis of relative benefit, relationship to, and connection with the contract. If there is little or no benefit to the government, the costs may be allocable only if they are

UAO to clean up the site.

"absolutely" necessary to the overall operation of the business.¹⁰⁵ The costs must be properly allocated to the government work, in the period that the costs were incurred. According to the FAR,

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefit received or other equitable relationship. Subject to the foregoing, a cost is allocable to a government contract if it-

- (a) is incurred specifically for the contract;
- (b) benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.¹⁰⁶

These are three separate categories of allocable costs and are stated in the disjunctive, so for environmental costs to be allocable they need only comply with one of the three requirements. However, all three cost categories are subject to the requirement of the first sentence of the provision that the cost must be assignable "in accordance with the relative benefits received or other equitable relationship."¹⁰⁷

If cleanup costs are the result of a release occurring during an existing

¹⁰⁵John Cibinic, Jr. and Ralph C. Nash, Jr. Cost Reimbursement Contracting, (forthcoming 1993), Chapter 5, George Washington University, National Law Center, manuscript on file with the author.

¹⁰⁶FAR 31.201-4

¹⁰⁷General Dynamic Corporation, Electric Boat Division, ASBCA No. 18503, 75-2 BCA 11,521.

government contract and there is a direct connection with the government contract, it will be a direct cost of the contract.¹⁰⁸ However, typically costs of cleanup will have no identifiable relationship to the existing government contract, and thus can only be allocated on the basis of necessity to the overall operation of the business.¹⁰⁹

Whether costs will be recovered on the basis of their necessity to the overall operation of the business depends on the relative necessity of the costs.¹¹⁰ The relationship between benefit and necessity was addressed by the Board of Contract Appeals in TRW Systems Group of TRW, Inc., when the board stated,

...it is clear and we hold that scope must be given to the element of "benefit" or other equitable consideration when determining the allowability of a necessary cost under ASPR 15-201.4 iii. Expenses which are absolutely necessary are for that reason alone beneficial to or bear an equitable relationship to government contracts. As the absolute necessity decreases, the contractor's burden to show some benefit or other equitable relationship with the government contract increases.¹¹¹

There must be a showing by the contractor either that the costs incurred are "absolutely" necessary to the survival of the contractor's business or if not "absolutely"

¹⁰⁸FAR 31.202(a)

¹⁰⁹Memorandum for Regional Directors, DCAA Director, Field Detachment, *Audit Guidance on the Allowability of Environmental Costs* from Michael J. Thibault, Assistant Director, Policy and Plans, 14 October 1992.

¹¹⁰Cibinic & Nash, Cost Reimbursement Contracting *supra* note 75 at 46.

¹¹¹TRW Systems Group of TRW, Inc. ASBCA No. 1149, 68-2 BCA 7119, 32,967.

necessary, that the government benefited from the costs incurred.¹¹²

Whether it is sufficient to show benefit which is general in scope or whether a more direct benefit is required, depends on the analysis of the cost and the facts and circumstances under which it was incurred.¹¹³

A showing of benefit, general in scope, was sufficient in TRW where the board held that United States patent costs were allocable to the government contract, finding the benefit to be "the protection afforded to the contractor which facilitated performance of the contracts and the...protection directly afforded the government against the payment of royalties [to others]".¹¹⁴ In Lockheed Aircraft Corp. local taxes assessed solely on commercial inventory was allowed on the basis that the taxes were to be used to provide community services of benefit to all the business undertaken by the contractor. "It was the price of membership in that community...the benefits flowed to government contracts...in a general way...by the very fact that Lockheed was meeting its responsibilities as a corporate citizen, and specifically benefited by the services provided by the community."¹¹⁵ Similarly, in Machine Products Company, Inc., payment of costs (attorneys fees, back wages, and arbiter expenses) incurred in a grievance procedure were found to benefit the

¹¹²Cibinic & Nash, Cost Reimbursement Contracting *supra*, note 75 at 46.

¹¹³General Dynamics Corp. Electric Boat Division, ASBCA No.18503, 75-2 BCA 11,521 at 54,973.

¹¹⁴TRW Systems Group of TRW, Inc. ASBCA No. 1149, 68-2 BCA 7119, 32,970.

¹¹⁵Lockheed Aircraft Corp. v. U.S., 375 F2d 786, 793 (Ct. Cl. 1967)

government on the basis that "every element of the cost was payment in support of a system to maintain harmonious industrial relations".¹¹⁶

In General Dynamics Corporation, Electric Boat Division, the board allowed allocation of commercial bid and proposal costs even though not an absolute necessity "in the sense that absent their incurrence the contractor would have had to close its doors". The board noted: "In a period when government business was on the decline, the costs were basic to appellant's viability as a commercial enterprise"¹¹⁷. See also Daedalus Enterprises, Inc. allowing foreign sales commissions;¹¹⁸ The Boeing Company, allowing personal taxes assessed on commercial inventories;¹¹⁹ and Martin Marietta Corporation, where "ad valorem" state property taxes assessed on work-in-process inventories used solely in connection with its fixed price government contracts were properly allocable to all its government work where general benefit was shown.¹²⁰ Though there are no published decisions on the allocability of environmental cleanup costs, it is apparent

¹¹⁶Machine Products Company, Inc. ASBCA No. 4577, April 14, 1959, 58-1 BCA 1704.

¹¹⁷General Dynamics Corp. Electric Boat Division, ASBCA No. 18503, 75-2 BCA 11,521 at 54,973.

¹¹⁸Daedalus Enterprises, Inc. ASBCA No. 43, 602, 1992 WL 114961 (May 18, 1992). See also, Aerojet General Corporation, ASBCA Nos. 17303 and 15704, 73-1 BCA 9932 where the costs of idle facilities were properly allocable even though no direct benefit to the government could be shown.

¹¹⁹The Boeing Company ASBCA No. 11866, 69-2 BCA 7868; *aff'd on reconsideration* 70-1 BCA 8298, *aff'd on appeal*, 480 F2d 854 (Ct. Cl. 1973)

¹²⁰Martin Marietta Corporation, ASBCA Nos. 14152, 71-1 BCA 8783

that cleanup costs, in many respects, fit squarely in the "absolute necessity" rationale (mandatory payments, a responsibility as a corporate citizen, basic to the corporations viability as a commercial enterprise, etc.).

However, allocation based on "necessity" is not without limits. In TRW, the board found the necessity for incurring *foreign* patent costs too remote to be allocable,¹²¹ and in Lockheed, the board cautioned,

We are not saying that any expenditure "necessary" to a business generally, and therefore beneficial to all output, should be allocated to government contracts... We are saying that necessity and benefit may have a somewhat different meaning for certain kinds of costs both as a matter of logic and policy. This may be an extremely limited area. In the present situation, we attribute much significance to the fact that the challenged cost was a tax. It happens that this tax was a local tax levied to cover community costs. Payment was not voluntary. These factors put it in a different category from charitable contributions, image-building or public relations expenses, and perhaps some other taxes. This distinction should illustrate that our approach does not lead to any litmus paper test for allocability.¹²²

A contractor cannot allocate purely commercial costs to government contracts under the guise of costs necessary for the overall operation of the business, where there is a direct relationship with another cost objective.¹²³ See Dynalelectron Corp., disallowing litigation costs incurred in a dispute related to a commercial transaction;

¹²¹TRW Systems Group of TRW, Inc. ASBCA No. 1149, 68-2 BCA 7119, 32,970

¹²²Lockheed Aircraft Corp. as cited in General Dynamics Corporation 75-2 BCA at 11,528.

¹²³Dynalelectron Corp., 545 F2d 736 (Ct. Cl. 1979)

and Chrysler Corporation¹²⁴ where costs incurred at an off-site facility for commercial production were not allocable because they were a direct cost of the commercial undertaking.

If the costs are not "absolutely necessary", there must be a showing of benefit.¹²⁵ Costs incurred in the operation of an international division were not allocable to the government contract without a showing that the government's interests were enhanced by the international development.¹²⁶ Similarly, costs of retraining employees for its commercial operations after losing a follow-on contract were not allocable to the government contract. There the board held,

...morale enhancement [did] not supply the requisite benefit to charge the [government] contract with retraining costs...Benefit accruing to the government contract [need not] be susceptible to precise mathematical measurement...but whether one takes a broad or narrow view of the benefit concept, there must be some reasonable relationship of the incurred costs to the contract to be charged.¹²⁷

Whether environmental cleanup costs will be considered "absolutely necessary" to the overall operation of the business will require a case-by-case determination. The recent audit guidance does not require that environmental damage be caused in the performance of a government contract, if the costs are properly allocable and

¹²⁴Chrysler Corporation, NASA BCA No. 1075-10, 77-1 BCA 12,482.

¹²⁵The Match Institution, HUDBCA No. 87-1850-C2, 91-2 BCA 23,994.

¹²⁶Id.

¹²⁷Metropolitan Life Insurance Company, ASBCA No. 27,161, 85-2 BCA 17,973

charged to proper period.¹²⁸ Whether this is another way of saying that cleanup costs are "absolutely necessary" and therefore no benefit or causation analysis is required, remains an open question. The guidance provides:

Costs to clean up environmental contamination caused in prior years will generally be period costs. In accordance with CAS 403, clean up cost should be allocated to the segment(s) associated with the contamination which in turn should allocate the costs to contracts as part of the segment residual G&A costs under CAS 410.¹²⁹

If the site is no longer occupied, costs are allocated to the segment where the work was transferred...whether the costs incurred for the closed segment should be directly allocated to other segments, be allocated as residual home office costs, or be treated as an adjustment of the extraordinary costs associated with the closing of the segment depends on the facts of the particular situation.¹³⁰

In determining the proper period to charge costs the audit guidance applies the Generally Accepted Accounting Principles outlined by the Emerging Issues Task Force (EITF):¹³¹

¹²⁸DCAA Audit Guidance, *supra*, note 6 at 3.

¹²⁹*Id.*

¹³⁰DCAA Audit Guidance, *supra*, note 6 at 3. When determining allocability of a closed segment, the guidance advises consideration of the following information: (1) Are any aspects of the closed segment's business being continued by the remaining segments? (2) Is the site still owned by the contractor? If so, what is its current use? (3) If the site is not presently owned by the contractor, what were the terms of the sale in relation to environmental costs? The contractor may have retained environmental cleanup liability in exchange for a higher sale price or the buyer may have accepted full liability in exchange for a lower price.

¹³¹ETIF Abstracts *Capitalization of Costs to Treat Environmental Contamination*, Issue No. 90-8, Journal of Accountancy 591, June 1991.

Environmental costs would normally be expensed in the period incurred, unless costs constitute a betterment or an improvement, or were for fixing up a property for sale. Betterments and improvements which exceed the contractor's capitalization threshold must be capitalized. Costs of fixing up a property for sale are generally considered to be a part of the sales transaction, if realizable from the sale.¹³²

According to this audit guidance, the test for allocability of environmental cleanup costs is different than the test for other types of costs. Environmental costs will be allocable whether or not they were connected with or benefited a government contract, as long as the costs were allocated to the proper segment. This is contrary to the existing law which requires at least some showing of benefit to the government contract. In the case of mandatory payments such as taxes or assessments, a showing of "general benefit" to the contract was sufficient for allocation. Many EPA or court ordered cleanup costs fit into this category. However, voluntary cleanup costs and cleanup, at third party sites, of wastes unrelated to past or present government contracts may not have the sufficient connection or benefit to be allocable to the government. To be consistent with existing case law, allocation to government contracts of a contractor's cleanup costs should not be automatic. There should be some showing of the absolute necessity of the expense or a benefit to the government contract.

II. SUMMARY

¹³²DCAA Audit Guidance, *supra*, note 6 at 3.

There is no easy recipe or checklist for determining whether environmental cleanup costs are allowable cost under a cost reimbursement type contract. Allowability will primarily depend on reasonableness, since in today's climate, many environmental cleanup costs have become an absolute necessity in the operation of a business. Reasonableness of the costs, depends on the contractor's conduct and the response of the enforcement agency. If the contractor's conduct results in fines or penalties, cleanup costs and legal costs will be disallowed. If there is a finding that a violation of law has occurred which caused the problem now requiring cleanup, cleanup costs, as well as legal costs, should be disallowed if found to be unreasonable under the circumstances. The contractor has the burden to show that their actions at the time of the "release" were reasonable, in light of the law and sound business practices at the time. Negligent conduct by the contractor or its employees may preclude reimbursement if the costs could have been avoided. A review of all the facts and circumstances is required to determine if the cost were incurred by a "prudent person in the conduct of a competitive business" in the "proper performance of the government contract."

CHAPTER 4
POST CONTRACT
RECOVERY OF CLEANUP COSTS UNDER CERCLA
"ARRANGER LIABILITY"

I. INTRODUCTION

Where the cleanup site was owned, operated or used by a DOD contractor, there is potential government liability for hazardous waste cleanup under CERCLA. CERCLA provides:

"Any person may seek contribution from any other person who is liable or potentially liable under section 9607(a)...In resolving contribution claims, the court may allocate response costs among liable parties using such equitable factors as the court determines are appropriate..."¹

CERCLA intended to cast a wide net to insure the ultimate responsibility for the costs of cleanup was on those responsible for the problems caused by the disposal of hazardous substances.² CERCLA, in Section 107, imposes liability for cleanup costs on "the owner or operator" of a facility, as well as "any person who at the time of disposal...owned or operated a facility at which such hazardous substances were disposed of; any person who...arranged for disposal or treatment...and any person who

¹42 U.S.C.A. §9613(f), CERCLA §113(f)

² Dedham Water Co. v. Cumberland Farms Dairy, Inc., 805 F2d 1074, 1081 (1st Circ. 1986) "Congress intended that those responsible for problems caused by the disposal of chemical poisons bear the costs of remedying the harmful condition they created".

accepted any hazardous substances for transport".³ The focus of this chapter is whether a company owned and operated facility (COCO) which performed government contracts can shift all, or part of the burden of environmental cleanup costs to the government on the basis that the government "arranged for the disposal and treatment of the hazardous substances" that caused the contamination. This chapter will review the environmental law on "arranger liability" and Chapter 5 will focus in on the application of that law to the Federal government as an "arranger" under CERCLA, Section 107(a)(3).

Potentially responsible parties who are vulnerable under the act as "arrangers" are defined as:

*any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substance...*⁴

There is no single rule for identifying when an entity becomes liable as an "arranger" under CERCLA §107(a)(3). However because courts have interpreted CERCLA broadly to achieve Congress's remedial purposes, they have expanded arranger liability well beyond those parties who intentionally sent wastes to a

³ CERCLA §107(a)(1)-(4), 42 U.S.C. §9607(a)(1)-(4); United States v A & F Materials Company, Inc. 582 F. Supp. 842,844 (S.D. Ill. 1984).

⁴ 42 U.S.C. §9607(a)(3) and 42 U.S.C. §9607(a)(4).

superfund site for disposal.⁵ Potential liability as an "arranger", ranges from one intentionally disposing of waste oil along the road of the rural south⁶ to one who contracts for product processing which results in disposal of hazardous wastes.⁷ To establish liability under CERCLA §107(a)(3), the contractor must prove the government: (1) was a person who owned or possessed hazardous substances; (2) by contract agreement or otherwise, arranged for the treatment or disposal, or arranged with a transporter for transport for disposal or treatment of those substances; (3) at a facility containing such substances; (4) there was a release or threatened release of a hazardous substance at the site that caused the incurrence of response costs.⁸

Because of the large number of hazardous waste site cleanups and the high stakes associated with superfund liability, there has been a flood of recent litigation interpreting the key terms in CERCLA section 107(a)(3) in an attempt to enlarge the body of potentially responsible parties.⁹ The critical concepts triggering "arranger liability" (also called "generator liability") are: "ownership/possession", "otherwise arranged for", "treatment", "disposal", "hazardous substance", and "facility".

⁵ The Reading Company v. The City of Philadelphia et al. 1992 WL 392595 (E.D.PA. 1991)

⁶ U.S. v. Robert Earl Ward, Jr. v. Norry Electric Corporation 618 F. Supp. 884 (ED NC 1985).

⁷ U.S. v. Aceto Agricultural Chemicals 699 F.Supp. 1384 (SD Iowa 1988) *Aff'd in part, rev'd in part* 872 F2d 1373 (8 Cir 1989); FMC Corp v. U.S. Department of Commerce, 786 F.Supp. 471 (ED Pa 1992).

⁸ 42 U.S.C. §9607; U.S. v Ward, 618 F. Supp at 893.

⁹ Environment Reporter Outlook 1993 Litigation, 23 ER 2530, January 22, 1993

A. Ownership/Possession

The ownership requirement includes not only actual ownership and possession, but also constructive ownership. To have constructive ownership "a nexus must exist in which a party has assumed responsibility for, or control over, the disposition of the hazardous waste".¹⁰ The necessary nexus is found in instances where a party took affirmative action which resulted in disposal or treatment at a site which ultimately resulted in release of the hazardous substance,¹¹ or where the party retained the authority to control the handling and disposition of a hazardous substance and, by failing to act, in effect decided upon the disposition.¹² Constructive possession has been found when a responsible party has been given authority by the actual waste owner, either as an employee of the owner corporation or as a broker paid by the owner, to decide on the owner's behalf where and how the waste would be disposed of.¹³ "It is the authority to control the handling and disposal of hazardous

¹⁰ CPC International, Inc. v. Aerojet-General Corporation et al. v. Cordova Chemical Company of Michigan, et al. 777 F. Supp. 549 (W.D. MI 1991)

¹¹ U.S. v. Bliss, 1988 WL 169818 (ED MO 1988); U.S. v. Ward 618 F.Supp. 844 (Ed ND 1985)

¹² U.S. v. Northeastern Pharmaceutical & Chemical Co. (NEPACCO), 810 F2d 726, 743 (8th Cir. 1986) *cert denied* 484 U.S. 848, 108 S.Ct. 146, 98 L.Ed 2d 102 (1987); U. S. v Mottolo, 629 F. Supp. 56, 58 (D.N.H. 1984), the person who arranges for disposal or transportation for disposal need not own or possess the hazardous waste.

¹³ The Hassayampa Steering Committee v. State of Arizona, 768 F. Supp. 697, 700 *citing NEPPACO*, 810 F2d at 744; U. S. v. Bliss, 667 F.Supp 1298, 1306 (E.D. 1987); and U. S. v. Mottolo 629 F. Supp at 60.

substances that is critical under the statutory scheme".¹⁴ For example, a state agency formed to increase ridership on commuter rail lines, was potentially responsible for the leakage of the oil from the trains' transformers as a result of their control over the design and use of the cars.¹⁵ A plant supervisor who actually knew about, had immediate supervision over, and was directly responsible for disposal was liable as arranger.¹⁶ Even though it's the concept of control that is the most important factor, there is no requirement that the "arranger" control the disposal¹⁷, choose the site,¹⁸ have knowledge of the facility where the waste is disposed¹⁹, or have knowledge that the substance was hazardous.²⁰

In 1984, the District Court in the Southern District of Illinois set forth the most

¹⁴ NEPACCO, 810 F2d at 743.

¹⁵ The Reading Company, 1992 WL 392595 at *15. (E.D. PA 1992).

¹⁶ NEPACCO, 810 F2d at 744.

¹⁷ U. S. v Aceto Agricultural Chemicals 699 F. Supp 1384 (S.D. Iowa W.D. 1988), *aff'd in part, rev'd in part* 872 F2d 1373 (8 Cir 1989); Jones-Hamilton 750 F.Supp 1022 (N.D.Cal, 1990), *aff'd in part, rev'd in part*, Jones-Hamilton v. Beazer Materials & Services, Inc. 959 F2d 126 (9th Cir, 1992) *amended and superseded on denial of rehearing* Jones-Hamilton Co. v. Beazer Materials & Services, 973 F2d 688 (9th Cir 1992); U.S. v. Velsicol Chemical Corp. 701 F.Supp 140,142 (WD Tenn. 1987); Levin Metals Corp. et al. v. Parr-Richmond Terminal Co. 781 F. Supp. 1448 (ND Cal. 1991)

¹⁸ United States v Bliss 20 Env't. L. Rep. 20,879, 1988 WL 169818 at *5 (E.D. Mo. 1988) ;State of Missouri v. Independent Petrochemical 610 F. Supp 4 (E.D. MO 1985); Aceto, 872 F2d 1273 at 1380. U.S. v. Ward, 618 F. Supp. at 894,895.

¹⁹ State of Missouri v. Independent Petrochemical Corp. 610 F.Supp 4 (E.D. Mo, 1985)

²⁰ U.S. v Bliss 1988 WL 169818 at *5.

often quoted rule: "the relevant inquiry is *who* decided to place the waste into the hands of a particular facility that contains hazardous waste."²¹ This rule has been expanded by, what has become known as, the *Aceto* line of cases, to include those who make decisions on the treatment of hazardous substances, not necessarily the decision on the waste.²² "Generator liability is imposed when the responsible person retains ownership of the raw material during the manufacturing or refining process and can be seen to have retained authority to control the work in process and disposition of the hazardous bi-product."²³ In *Aceto*, the chemical company defendants manufacturing pesticides had a contract with the plaintiff "formulator" to take active pesticide ingredients and process them to produce a commercial grade product, which was then sold to farmers and other consumers. The court found arranger liability because the manufacturers (1) "owned the technical grade pesticide, the work in process, and the commercial grade pesticide while in the formulators possession", and (2) "the generation of pesticide-containing waste through spills, cleaning of equipment, mixing and grinding operations, and production of "out of spec" batches was an *inherent* part of the formulation process". It was irrelevant that the contract was for the processing of a valuable product (not the disposal of a waste) and that the formulator alone controlled the processes, as well as any waste

²¹ *U.S. v A & F Materials*, 582 F.Supp. at 845

²² *Aceto* line of cases. See footnote 17.

²³ *Aceto*, 872 F2d 1373.

disposal that resulted therefrom.²⁴ See also Jones Hamilton Co. v. Beazer Materials & Services, Inc. holding the defendants liable because they retained ownership of all materials they supplied, the materials were hazardous substances, and the agreement "contemplated" the spillage. Ownership of the raw materials, not control was key²⁵. In U.S. v. Shaner, liability was imposed upon companies that provided hazardous substances to another company for "processing and return"²⁶ and in Levin Metals there was potential responsibility when waste and disposal were inherent in the process.²⁷

In general, liability "ends with that party who both owned the hazardous waste and made the crucial decision how it was to be disposed of or treated, and by whom."²⁸ In Edward Hines Lumber Company, the defendant chemical supplier incurred no CERCLA liability despite a close relationship with a lumber treater which it advised and consulted concerning the design and location of treatment

²⁴ *Id* at 1382

²⁵ Jones Hamilton Co. v. Beazer Materials & Services, Inc. 959 F.2d 126, 131 (9th Cir. 1992)

²⁶ U.S. v Shaner, 20 CHEM. WASTE LIT. REP. 1130, 1135, 1990 WL 115085 (E.D. Pa. June 25, 1990). See also Levin Metals Corp v. Parr- Richmond Terminal Co. 781 F.Supp 1448,1451 (N.D. Cal. 1991).

²⁷ Levin Metals Corp. 781 F. Supp. at 845. Contrast Kelly v Arco Industries, 739 F.Supp. 354 (WD MI 1990).

²⁸ U.S. v Westinghouse Electric 22 Env't Rep (BNA), 1230, 1233 (S.D. ind 1983); Jersey City Redevelopment v PPG Industries, 655 F. Supp. 1257, 1260 (D. NJ 1987); U. S. v A & F Materials, 582 F. Supp. at 845.

systems.²⁹ Similarly, a state's manifest system giving permission to deposit hazardous waste did not create the necessary nexus to find "arranger" liability, because it was the owners, not the state, who made the critical decisions.³⁰ A secured creditor in bankruptcy, which sold property in order to protect its security interest did not "arrange for disposal" of the wastes subsequently found on the land, where the bank made no "crucial decisions regarding disposal of hazardous substances or take any other affirmative action regarding disposal".³¹ But see United States v. Fleet Factors Corporation, where the secured creditor, having knowledge of the existence of large quantities of hazardous substance, made an agreement with a third party to prepare the site for and conduct an auction, and "leave the plant in a broom clean condition" arranged for disposal.³²

Generally, entities which merely have the opportunity or ability to control a third party's waste disposal practices, or the mere existence of economic bargaining power which would permit one party to impose certain terms and conditions on another

²⁹ Hines v Vulcan Material Company, 685 F. Supp. 651, 654 (ND Ill, 1980)

³⁰ Hassayampa Steering Committee, 708 F.Supp at 770. See *also*, U.S. v. Berks Associates, Inc. 1992 WL 68346 (ED Pa. 1992) where the EPA was not liable as an arranger when conducting cleanup activities, in accordance with their statutory and regulatory authority.

³¹ Ashland Oil v Sonford Products, 1993 WL 6455, at *3 (D.Minn 1993)

³² United States v. Fleet Factors Corporation, 1993 WL 156633 * 14 (S.D.GA). Note that Fleet Factors was liable as "owner" under 107(a)(2) because of its involvement in the operations of the plant, however, this finding precluded "arranger" liability under CERCLA 107(a)(3). "Fleet's holding of title through its deed to secure debt renders it an owner and thereby precludes finding Fleet liable under §9607(3)."

does not create an obligation under CERCLA.³³ In General Electric v AAMCO, even though the oil company encouraged sale of waste oil, leased the underground tanks from which the release occurred, and periodically inspected the premises according to the lease agreement, there was not a sufficient nexus to the disposal to find arranger liability. The fact that the company did not own the hazardous substance, control the processes by which waste motor oil was generated, or require the oil changes be performed were dispositive.³⁴ However, in FMC v. U.S. (the case that opened the door for COCO contractors cleanup cost recovery from the government), ability and the opportunity to control the disposal were significant factors in finding liability.³⁵ The court in FMC found the federal government liable as an "arranger" for contamination resulting from the production of rayon cord used for airplane and jeep tires. The government contracted with FMC for production, but did not own any of the raw materials, work in process, hazardous substances, or make any of the decisions on disposal. The court focused on the government's involvement in the production and held they "knew, or should have known" the disposal or treatment of a hazardous substance would result, noting that the War Production Board "ordered the company to convert and expand the plant,... set

³³ General Electric Company v. AAMCO Transmissions 962 F2d 281, 286 (2nd Cir 1992) *citing* New York V. General Electric Co., 592 F. Supp 291, 297 (N.D.N.Y. 1984).

³⁴ General Electric v. Aamco Transmission, 962 F2d at 286. *See also* U.S. v. Arrowhead Refining Company 1992 WL 437429,*8 (D. Minn 1992) where the requirement to perform oil changes did not change the result.

³⁵ FMC Corp v. United States Department of Commerce, 786 F.Supp. 471 (E.D.Pa. 1992).

production levels,... arranged for and oversaw the design and installation of the government equipment at the site,... and during the time that government personnel were at the site, there was a large amount of highly visible waste disposal activity."³⁶

B. Otherwise arranged for...

The determination of whether a "person" has "otherwise arranged for" the disposal or treatment of a hazardous substance is not straight forward and hinges on whether the transaction was a bonafide sale or an agreement for treatment or disposal. The phrase "otherwise arranged for" is not defined by the statute and the legislative history sheds little light on the interpretation of the phrase.³⁷ However, the courts have consistently concluded that a liberal judicial interpretation is consistent with CERCLA's "overwhelmingly remedial" statutory scheme.³⁸

1. The Agreement

There must be an agreement, however it does not have to be formal, written, or for the disposal of a waste. See Ward, where an oral agreement was sufficient to

³⁶ Id. at 472-485.

³⁷ U.S. V. Aceto 699 F.Supp at 1386; U.S. v. Mottolo 605 F.Supp. at 902.

³⁸ NEPACCO, 810 F 2d at 733, U.S.v. Conservation Chemical Co. 619 F Supp at 192; See also: Aceto, 872 F2d at 1380, footnote 8: "Although the 96th Congress had considered numerous proposals concerning liability and compensation for environmental pollution, the bill which ultimately became law was hurriedly put together...and passed after very limited debate by a lame duck Congress." Of the three bills reported out of congress, none of them used the term "arranged for".

impose liability³⁹; Conservation Chemical, where the contractual relationship found in the agreement for disposal at one site was extended by the court to include subsequent removal to another site where the release occurred⁴⁰; and Aceto, where the agreement was not for disposal of waste, but for processing a product, yet the court imposed liability because waste disposal was "inherent in the processing".⁴¹ See also Levin Metals Corp., where an agreement to dispose of DDT lost in processing was implied by providing a "spillage allowance".

However, in CPC International the court found no agreement or arrangement for disposal in a "Stipulation and Consent Order" for the cleanup of contaminated ground water. The court held "the agreement was for cleanup and not for the contamination that resulted".⁴² Similarly, Dow Chemical Corporation did not "arrange for disposal" by issuing technical advice on the proper disposal of herbicide in the event of a spill or leak.⁴³

³⁹ U.S. v. Ward 618 F.Supp. at 894.

⁴⁰ U.S. v Conservation Chemical, 619 F.Supp. 162, 234 (WD Miss 1985). Selection of the disposal site by a generator is not a prerequisite to liability. "Section 107(a)(3) does not say that the generator must have "arranged for disposal or treatment...at *the* facility"; rather, the statute imposes liability upon any person who "arranged for disposal or treatment ... at *any* facility owned or operated by another entity" [emphasis in original quote].

⁴¹ Aceto, 872 F2d 1273.

⁴² CPC International v Aerojet-General 777 F.Supp. at 576

⁴³ Jordan v. Southern Wood Piedmont Co., 805 F. Supp. 1575 (S.D. Ga. 1992)

2. *State of Mind*

Though state of mind is generally not a factor,⁴⁴ knowledge and motive play a role in finding liability.⁴⁵ The court in determining whether there is an agreement for disposal, looks to the motivation of the defendant and the reason for the contract. In Ward, the court found liability in part because the defendant clearly intended to "get rid of" the PCB-laden oil which had become a problem for him to maintain.⁴⁶ General Electric was held liable for the sale of used transformer oil when they arranged with a dragstrip to remove the substances from the GE plants "with knowledge or imputed knowledge" that the substances would be deposited on the land surrounding the dragstrip.⁴⁷ See also United States v. Vesicol Chemical Corporation, finding liability when defendants arranged for a company to formulate and package products and defendant knew or should have known that there would be losses through spills or leaks and that wastes would be generated in the process⁴⁸; and FMC v. U.S. where the federal government was held liable for contamination resulting from a contractors activities because it "knew or should have

⁴⁴ State of New York v. Shore Realty Corp 759 F2d 1032, 1044 (2nd Cir 1985); U.S. v Bliss 1988 WL 169818 at *5 (E.D. Mo. 1988)

⁴⁵ U.S. v Pesse 794 F.Supp. 151, 157 (WD Penn, 1992)

⁴⁶ U.S. v Ward as cited in Consolidated Rail Corporation 729 F.Supp. at 1469

⁴⁷ New York v. General Electric Company, 592 F.Supp. 291, 297 (ND NY 1989).

⁴⁸ Velsicol Chemical Corp, 701 F.Supp. 140 (WD Tenn 1987)

known" how the wastes were being disposed.⁴⁹ Contrast with Hines, where the manufacturer was not liable for contamination caused by a chemical they sold even though they "knew or should have known" that the process run-off was stored in a holding pond.⁵⁰

3. Sales

Bonafide sales of a "useful" substance will not result in liability, even if the product subsequently is disposed of and causes a release.⁵¹ However the courts have looked closely at these arrangements and beyond the defendants' characterizations to determine whether a transaction, in fact, involves an arrangement for the disposal/treatment of a hazardous substance.⁵² Generator liability under CERCLA does not depend on the product's commercial value, but on whether the arrangement was for disposal or treatment.⁵³ See States v BFG Electroplating and Manufacturing, where the sale of cinder blocks pursuant to a "Consent Order and

⁴⁹ FMC Corp. v U.S. 785 F.Supp at 471.

⁵⁰ Hines v Vulcan Material Company, 685 F. Supp at 655.

⁵¹ U.S. v. Westinghouse 22 Environment Reporter (BNA) 1230, 1233 (SD IND 1983), the original supplier of PCBs was not liable for the ultimate disposition; Florida Power and Light v. Allis-Chalmers Corp. 893 F.2d 1313,1314, the manufacturer of transformers was not liable for the ultimate disposal, since it sold the utility new, useful products and the utility made the decision to dispose; General Electric v. AAMCO 962 F2d at 286, sale of virgin oil used in oil changes did not result in liability for the ultimate disposal of waste oil.

⁵² Aceto, 872 F2d at 1380

⁵³ A & F Materials 582 F.Supp. at 845.

Agreement" to dispose of the contaminated blocks, was an arrangement for disposal even though the blocks were a useful substance for construction.⁵⁴ Similarly, sale of used transformer oil to a dragstrip for dust control,⁵⁵ sale of scrap metal which the operator of the site used as raw material in its manufacturing process;⁵⁶ and sale of a caustic solution generated as a by-product in the manufacture of jet engines for use by a waste oil purchaser for a neutralization process were "arrangements" for treatment/disposal.⁵⁷ The common thread in many of these cases was the substances being transferred were wastes, scrap, or by-products of the generator's manufacturing process and "could no longer be used for their intended purposes", ie. could not be used productively without processing.⁵⁸

In U.S. v. Summit Equipment, sellers of used, surplus equipment at a blind auction were liable as generators, even if they did not know that the purchaser intended to scrap their equipment rather than reuse it.⁵⁹ In Conservation Chemical, the sale of lime slurry and fly ash by-products to a recycler, which then was used to neutralize and treat other hazardous substances at a hazardous waste site, was

⁵⁴ States v. BFG Electroplating and Manufacturing Company, Inc. 1990 WL 67983 at *1 (W.D.PA.)

⁵⁵ New York v. General Electric Company, 592 F.Supp. 291 (N.D.N.Y. 1984)

⁵⁶ U.S. v Pesses, 794 F.Supp. 151 (WD PA 1992)

⁵⁷ U.S. v A & F Materials, 582 F.Supp. at 845

⁵⁸ U.S. v. Pesses, 794 F.Supp. at 157

⁵⁹ U.S. v. Summit Equipment 805 F.Supp 1422 (N.D Ohio, 1992).

"arranging for disposal".⁶⁰ In contrast, a seller was not liable as an "arranger" for the sale of fly ash that the broker was to use its "best efforts" to sell for use in road construction.⁶¹

Courts have refused to impose CERCLA liability if a party merely sells a product containing a hazardous substance, without additional evidence that the transaction involved an "arrangement" for the ultimate treatment or disposal.⁶² In one of the earliest arranger cases, Westinghouse was not able to recover costs from Monsanto for cleanup of PCB contaminated soil resulting from transformers purchased from Monsanto 40 years previously.⁶³ Sale of a chemical for use in the wood treatment process did not constitute arranging for the disposal or treatment of a hazardous substance, even when "process run-off containing the substances [was found] at the same site."⁶⁴ Similarly, sale and transportation of pesticides to a farm

⁶⁰ U.S v Conservation Chemical Company, 619 F.Supp 162 (WD Miss 1985)

⁶¹ U.S. v. Peterson Sand and Gravel Inc. 806 F.Supp. 1346, 1354 (ND. Ill. 1992) "Seller liability for thater misuse by the buyer of useful but hazardous ingredients in a manufacturing process was not intended by CERCLA's authors; such liability would chill permissible manufacuting.

⁶² U. S. v Pesses 794 F.Supp. at 156

⁶³ Westinghouse 22 Environment Reporter 1230, (SD Ind 1983). See also Florida Power & Light Company v. Allis Chalmers Corporation 893 F2d 1313 the manufacturer of transformers was not liable for arranging the disposal, where the purchaser used the product for 40 years and made all the arrangements for disposal.

⁶⁴ Hines v Vulcan Material, 655 F. Supp at 655. See also, Kelly v. Arco Industries 739 F.Supp. 354,359 (WD MI 1990) supplier of a compound containing a hazardous substance not liable.

site for field application;⁶⁵ and, an auction sale of used transformers having 12 years remaining useful life, were not arrangements for disposal.⁶⁶ Sale of the entire chromium ore processing business was not an arrangement for disposal of the contaminated waste mud, even though the original owner foresaw that the waste mud might be sold as landfill by future owners.⁶⁷ Liability ended when the subsequent owner contracted independently to remove the mud from the property for use as landfill in an excavation project which was subsequently found to be contaminated.⁶⁸ However, there was potential liability when the sale of the business was at a significantly discounted price.⁶⁹

C. Treatment or Disposal of a Hazardous Substance

CERCLA, Section 107(a)(3) liability encompasses hazardous wastes and primary products, however liability attaches only to those parties who transact in a

⁶⁵ South Florida Water Management District v. Juan Montalvo et al. 1988 WL 242688 *2, (S.D. FLA, 1988)

⁶⁶ U.S. v. Gordon Stafford, Inc. 1993 WL 6873 *8, (N.D. Va, 1993)

⁶⁷ Jersey City Redevelopment v. PPG Industries, 655 F.Supp. 1257, 1260 (DNJ 1987). The court distinguished this case from those where the defendant engaged in a specific transaction concerning the hazardous substance. See also, AM International, Inc. v International Forging Equipment, 982 F2d 989, (6th Cir. 1993).

⁶⁸ *Id. at* 1259.

⁶⁹ Sanford Street Local Development Corporation v. Textron, 768 F.Supp. 1218, (WD MI 1991), foundry purchased for \$25,000 when its appraised value was \$200,000 "suggested that" the decision to sell the foundry was a transaction for the disposal of hazardous materials that could subject the seller to liability under CERCLA.

hazardous substance in order to dispose of or treat the substance.⁷⁰

1. Treatment

CERCLA incorporates the definition of treatment found in the Solid Waste Disposal Act:⁷¹

"any method, technique, or process, including neutralization, designed to change the physical, chemical, or biological character or composition of any hazardous waste so as to neutralize such waste.... Such term includes any activity or processing designed to change the physical form or chemical composition of hazardous waste so as to render it nonhazardous."⁷²

Treatment, under CERCLA, applies to hazardous substances and hazardous wastes. Persons who arrange for treatment of hazardous wastes are liable for contamination caused by treatment. Scrap metal sold to a company for resale which required "melting, shearing, cleaning, crushing, sawing, banding, drilling, tapping...etc. to make alloys was held to constitute "treatment", since the buyer's "processing necessarily acted to: ...change the physical, chemical, or biological character or composition of a hazardous waste".⁷³ Similarly, the generator of "lime slurry" sold

⁷⁰ Hines v. Vulcan Materials, 655 F.Supp. at 655

⁷¹ CERCLA Section 101(29), 42 U.S.C. 9601(29); Solid Waste Disposal Act Section 1004, 42 U.S.C. 6903(34).

⁷² *Id.*

⁷³ U.S. v. Pesses 794 F.Supp. at 157

to a landfill to treat and neutralize other wastes, was liable under §107(a)(3).⁷⁴

2. Disposal

Disposal is defined as:

the discharge, deposit, injection, dumping, spilling, leaking, or placing of any solid waste or hazardous waste into or on any land or water so that such solid waste or hazardous waste or any constituent thereof may enter the environment or be emitted into the air or discharged into any waters, including ground waters.⁷⁵

The definition is broad, but the application can be surprisingly fact specific. Disposal includes activities that occur after the "initial disposal" (moving and dispersing hazardous materials from an old landfill to build a housing development,⁷⁶ but not dispersing contaminants while building a water main in contaminated soil).⁷⁷

There is an ongoing debate on whether the disposal definition includes the general movement of and migration of a hazardous substance which had been previously spilled ("passive disposal") or requires defendant's affirmative act. The

⁷⁴ U.S. V. Conservation Chemical, 619 F. Supp 162 (WD Mo 1985).

⁷⁵ 42 U.S.C. §6903 (3) (1982)

⁷⁶ Tanglewood East Homeowners, 849 F2d 1568 (5 Cir 1988). In Tanglewood a subdivision of homes was constructed on highly contaminated land where there had been a wood treatment facility. The contractor filled-in open pools and regraded the land, in attempt to make the property presentable to future landowners.

⁷⁷ Brookfield North Riverside Water Commission v. Demetrios Billakis, 1992 WL 63274 (ND Ill, 1992).

courts are about evenly split.⁷⁸ Ecodyne Corp. v. Shah is the leading case interpreting disposal as requiring an affirmative act.⁷⁹ The court examined the definitional components and found that the "three nouns (discharge, deposit, and injection) and four gerunds (dumping, spilling, leaking, and placing) when read together, all have in common the idea that someone do something with hazardous substances".⁸⁰ In asbestos cases, it is clear that disposal requires an affirmative act.⁸¹ Depositing hazardous waste into enclosed containers is enough of an affirmative act to fit within the definition of disposal;⁸² however, leakage and leaching from barrels does not necessarily trigger CERCLA liability.⁸³ In contrast in The Reading Company, leakage of PCB laden oil from transformers used to

⁷⁸ Nurad, Inc. v. William E. Hooper & Sons Co. 966 F. 2d 837, 844-46 (cir. 1992) "passive" is enough for Section 9607 (a); U.S. v. Waste Industries, Inc. 734 F. 2d 159,164 (4th Cir. 1984) disposal includes passive disposal under RCRA; Stanley works v. Syndergeneral Corp. 781 F. Supp. 659 (E.D. 1990) passive is enough. Ecodyne v. Shah, 718 F. Supp. 1454, 1455-57 (N.D.Cal. 1989) rejecting passive disposal based on grammatical construction; In re Diamond Reo Trucks, Inc. 115 B.R. 559, 565-66 (W.D. Michigan) adopting Ecodyne.

⁷⁹ Ecodyne v. Shah, 718 F.Supp. 1454, 1456 (N.D Cal. 1989).

⁸⁰ *Id.*

⁸¹ Prudential Insurance Company of America v. United States Gypsum, 711 F Supp 1294 (DC NJ, 1989).

⁸² Westwood Pharmaceutical, Inc. v. National Fuel Gas Distribution Corp. 737 F.Supp. 1272,1278 (WDNY 1990), *Aff'd*, 964 f2d 85 (2nd Cir 1992)

⁸³ U.S. v Petersen Sand and Gravel, 806 F. Supp 1346 (N.D. Ill, E.D. 1992). Most of the cases discussing "disposal" are §107(a)(2) cases. Under §107(a)(2) any person "at the time of disposal" owned or operated a facility at which hazardous substances were disposed of can be held liable.

operate railroad cars was held to be "disposal" under §107(a)(3).⁸⁴

3. Hazardous Substances

CERCLA was "designed to cover hazardous materials which were of nominal commercial value and which were sometimes sold or reused and sometimes discarded".⁸⁵ The statute defines "hazardous substance" broadly to include:

(a) any substance designated pursuant to §311(b)(2)(A) of Title 33, (B) any element, compound, mixture, solution or substance designated pursuant to §9602 of CERCLA, (C) any hazardous waste having the characteristics identified or listed under RCRA ..., (D) any toxic pollutant listed under §1317(a) of Title 33, (E) any hazardous air pollutant listed under the Clean Air Act..., and (F) any imminently hazardous chemical substance or mixture with respect to which the Administrator has taken action pursuant to §2606 of Title 15... The term does not include petroleum...or natural gas....⁸⁶

There has been extensive litigation on the parameters of "hazardous substance" under CERCLA and in every case, if the substance or waste (or any element thereof) in dispute could be defined as hazardous in any of the listed statutes, liability was found, no matter what the concentration,⁸⁷ ("less than

⁸⁴ The Reading Company 1992 WL 392595 at *15 (ED PA 1992)

⁸⁵ A & F Materials, 582 F.Supp. 842, 894 (Sd Ill. 1984)

⁸⁶ 42 U.S.C. §9601(14)

⁸⁷ United States v Melvin R. Wade 577 F.Supp. 1326, 1339 (ED PA 1983)

background" did not preclude liability).⁸⁸ A material that is not hazardous waste under Resource Conservation and Recovery Act ("RCRA") may still be considered a hazardous substance under CERCLA⁸⁹ and there is no quantitative requirement on what constitutes a "hazardous substance".⁹⁰ A waste is a hazardous substance if it contains substances listed as hazardous under any of the statutes listed in CERCLA §101(14), regardless of the volume or concentration of those substances.⁹¹ A waste material that is not specifically listed as a hazardous substance in 40 C.F.R. §302.4 is nonetheless hazardous under CERCLA if it contains a CERCLA hazardous substance.⁹² Hazardous metals in grinding sludge, even if "permanently bonded into alloys that will not break down into their constituent elements" are covered under CERCLA.⁹³

D. Facility

CERCLA defines the term "facility" very broadly and "dispels any notion that

⁸⁸ U. S. v. Alcan 755 F. Supp. 531 (N.D.N.Y. 1991), *affirmed* 964 F2d 252 (3 Cir. 1992).

⁸⁹ U.S v Conservation Chemical Corp 619 F.Supp. 162,237 (WD Miss 1985)

⁹⁰ Louisiana-Pacific Corp. V. ASARCO, Inc. 735 F.Supp 358, 361 (W.D.Wash 1990). *But note*, CERCLA does have threshold amounts for release reporting purposes.

⁹¹ Hassayampa Steering Committee v Arizona 768 F.Supp. 69732 (D. Ariz. 1991)

⁹² Eagle-Picher Industries, Inc. v. U.S. E.P.A. 759 F. Supp 665, 673 (D.C. Cir. 1985)

⁹³ Arizona v. Motorola, 774 F.Supp 566 (D. Ariz. 1991)

CERCLA was designed to cover only traditional dump sites."⁹⁴ A facility is considered to be any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located..."⁹⁵ The court in Conservation Chemical, defined the breadth of the term when it said, "simply put, the term "facility" includes every place where hazardous substances come to be located."⁹⁶ There is no requirement of preexisting disposal of hazardous substances.⁹⁷ The legislative history makes it clear that Congress sought to deal with every conceivable area where hazardous substances come to be located ("dirt roads in Texas contaminated with nitrobenzene and cyanide as a result of oiling,"⁹⁸ radium waste sites scattered throughout Colorado found to be "under restaurants, in empty lots where children play, [and] near factories...").⁹⁹ In Brookfield North Riverside Water Commission, the area into which the contractor installed the water main was a "facility" because it contained hazardous substances. In fact, not only was the construction site a "facility", but after hazardous substances entered the water main, the water main, too, became a facility. "There does not appear to be a limit to the

⁹⁴ New York v. General Electric Company 592 F.Supp 291, 296 (N.D. N.Y. 1984)

⁹⁵ 42 U.S.C. §9601(9)(b)

⁹⁶ U. S. v Conservation Chemical 619 F. Supp. at 185.

⁹⁷ New York v. General Electric Company, 592 F.Supp 291, 296 (N.D. NY 1984)

⁹⁸ 126 Cong. Rec. H9447 (daily ed. Sept. 23, 1980) as cited in New York v General Electric Company 592 F.Supp. at 296 at 296.

⁹⁹ 126 Cong Rec. S14975 (daily ed. Nov. 24, 1980) as cited in New York v General Electric at 296.

number of facilities that can be created by the migration of hazardous substances."¹⁰⁰ A real estate subdivision¹⁰¹, and electric railroad cars with motors using electrical transformers which contained PCB's were also facilities.¹⁰² In FMC, the District Court found the "spinning machines" the government provided to the contractor were "facilities" to be treated separate from the contractor's facility.¹⁰³

II. SUMMARY

All the elements of arranger liability are interpreted broadly to insure the burden of hazardous waste cleanup is borne by those who produced and profited by the production and use of hazardous materials. The key factual issues in "arranger liability" are the ownership or control over the hazardous substances, control over the processes that cause the contamination, and *who* made the decisions on disposal. To be liable under CERCLA §107(a)(3) as an "arranger", the "person" must own, possess or control the hazardous substance, make or control the decision on its disposal, or have the authority to control and take control over its treatment, handling, or disposition. If the person is not directly involved with the ultimate disposition of the waste, there is liability if the person (1) supplied the raw materials; (owned or

¹⁰⁰ Brookfield North 1992 WL 63274 at *4

¹⁰¹ U.S. v. Metate Asbestos Corp. 584 F. Supp. 1143, 1148 (D. Ariz. 1984)

¹⁰² The Reading Company v. the City of Philadelphia, 1992 WL 392595 (ED PA 1991)

¹⁰³ FMC v U.S., 786 F. Supp. at 485-487.

controlled the work in process, where (3) the generation of hazardous substances was an inherent in the production process.¹⁰⁴

The obvious trend in "arranger liability" is expansion, however, there was some sign of new limits in General Electric Company V. AAMCO when the court held that the opportunity or ability to control a third party's waste disposal practices or the mere existence of economic bargaining power which would permit one party to impose certain terms and conditions did not create an obligation under CERCLA.¹⁰⁵ Similarly in Peterson Sand and Gravel, the District Court of Illinois, for the first time appeared to consider the impact of continual expansion of CERCLA liability on manufacturing. The court adopted arguments, uniformly rejected previously, that the sale of a hazardous by-product (fly ash) was a sale of a useful product (even though some admittedly was purely waste), stating "seller liability for the later misuse by the buyer of a useful product was not intended by CERCLA, such liability would chill permissible manufacturing."¹⁰⁶ However, absent these and the other isolated cases discussed previously, there are few avenues of escape for those involved with hazardous materials. Given the expansive interpretations of hazardous substance (less than background, sufficient)¹⁰⁷; facility

¹⁰⁴ Aceto line of cases, *supra* at note 17.

¹⁰⁵ General Electric v. AAMCO Transmissions 962 F2d 281 (2nd Cir 1992); U.S. v Arrowhead Refining Company 1992 WL 437429 (D. Minn 1992)

¹⁰⁶ U.S. v. Peterson Sand and Gravel, Inc. 806 F.Supp. 1346 (ND. Ill. 1992)

¹⁰⁷ U.S. v Alcan, 964 F2d 252 (3rd Cir 1991)

(anywhere a hazardous substance comes to be located)¹⁰⁸; disposal (leakage sufficient)¹⁰⁹; and treatment (any process designed to change the character)¹¹⁰, few are avoiding potential "arranger" liability. Whether, and under what circumstances, DOD will share cleanup costs with contractors as "arrangers" will be determined by their control over the contractor's disposal practices and the interpretation and application of CERCLA's waiver of sovereign immunity.

¹⁰⁸ 42 U.S.C. §9601(a)(6)

¹⁰⁹ The Reading Company v. City of Philadelphia, 1992 WL 392595 (ED PA 1991)

¹¹⁰ 42 U.S.C. §9601(29)

CHAPTER V
POST CONTRACT RECOVERY
THE FEDERAL GOVERNMENT AS "ARRANGER"

I. INTRODUCTION

The liability of the United States is limited by the terms of CERCLA's waiver of sovereign immunity which defines the courts jurisdiction to entertain suit.¹ CERCLA includes the "United States Government" in the term "person" and expressly waives sovereign immunity.² However CERCLA's waiver, while expressed is not unlimited.³ It provides:

Each department, agency, and instrumentality of the United States (including the executive, legislative and judicial branches of government) shall be subject to, and comply with this chapter *in the same manner and to the same extent*, both procedurally and substantively, *as any nongovernmental entity*, including liability under section 107 of this title.⁴ [emphasis added]

"Waivers of sovereign immunity must be construed narrowly in favor of the

¹U.S. v. Sherwood, 312 U.S. 584, 586 (1941)

²42 U.S.C. §9613, CERCLA §113. Any person may seek contribution from any other person. 42 U.S.C.A. §9601(21), CERCLA §101(21). The term "person means an individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body.

³Pennsylvania v. Union Gas Co., 491 U.S. 1, 10 (1989); U.S. v. Berks Associates, Inc. 1992 WL 68346, *3 (E.D. PA, April 1, 1992); United States v. Western Processing Company, 761 F. Supp 725 (W.D. Washington, 1991)

⁴42 U.S.C.A 9620(a)(1), CERCLA §120(a)(1).

government.⁵ The courts have interpreted the terms "[liability] in the same manner and to the same extent as any nongovernmental entity" as limiting the waiver to activities analogous to a business concern and not to acts done in its sovereign or regulatory capacity.⁶ The waiver is limited to circumstances under which a private party could also be held liable.⁷

A. Federal Government Liable as "Arranger"

FMC v. U.S., decided by the U.S. District Court in Pennsylvania was the first published case finding the Federal government liable for "arranging for" the disposal and treatment of hazardous substances as a result of entering into supply contracts

⁵United States v. Nordic Village Inc. 112 S.Ct. 1001, 1015 (1992); Ohio v. Department of Energy 60 U.S.L.W. 4325, 4333 (1992) waivers of immunity must be construed strictly in favor of the sovereign...and not enlarge[d] ... beyond what the language requires; EPA v. California ex rel. State Water Resources Control Board, 426 U.S. 426 U.S. 167, 182-199 (1976); U.S. v. Sierra Club, 463 U.S. 680 (1983); Hancock v. Train 426 U.S. 167 (1943).

⁶U.S. v. Dart Industries, 847 F.2d 144,146 (4th Cir. 1988) a state's negligent enforcement of environmental regulations do not constitute ownership of control as defined by 42 U.S.C. 9601;U.S. v. Berks Associates, 1992 WL 68346 (E.D. PA, April 1, 1992) EPA's negligent cleanup under CERCLA is not actionable; In re: Paoli Railyard PCB Litigation, No. 86-2229 (April 29, 1992 E.D. Pa.); United States v. Western Processing Co., 761 F. Supp. 725,730 (W.d. Wash 1991); B.R. McKay & Sons, Inc. v. United States, 633 F. Supp. 1290, 1296 n.9 (D. Utah 1986) CERCLA's waiver of sovereign immunity does not allow claims against the United States as regulator.

⁷U.S. v. Berks Associates, Inc. 1992 WL 68346, *3 (E.D. PA, April 1, 1992) The U.S. may be held liable under CERCLA §107(a)(1)-(4) if it is an owner, operator, transporter or generator, however unless the U.S. fits into one of those descriptions it is immune from CERCLA liability.

with a Company Owned, Company Operated (COCO) contractor.⁸ The court found the government liable as an "arranger" for groundwater contamination resulting from World War II contracts for the production of high tenacity rayon cord.⁹ FMC was the third owner of the company since the war and, as the only remaining "responsible party",¹⁰ incurred significant cleanup costs from 1985 through present.¹¹

The court made 182 findings of facts, which highlighted the governments involvement with FMC in the production of rayon cord, noting: the urgency of the "High Tenacity Rayon Yarn Program"; the government's requirements to increase quantities and to convert and expand its plant; the governments "active control and hands-on participation" in the facilities conversion; the government's control of the supply of raw materials; government's participation in obtaining and retaining a labor force at the facility; government's on-site presence at the facility; government's specifications; government's control of price and profit; the government's receipt of information relating to "virtually all aspects of the facility"; governments's knowledge that the disposal or treatment of hazardous substances was inherent in the

⁸FMC v. U.S. Department of Commerce, 786 F. Supp. 471 (E.D. Pa. 1992) The court also held the government liable as an "operator" under CERCLA 107(a)(3).

⁹*Id at* 485.

¹⁰*Id at* 473. The plant was owned and operated by American Viscose (now out of business) from 1940 to 1963, by FMC from 1963 to 1976, and by Avtex Fibers (in bankruptcy reorganization) from 1976 to 1989.

¹¹*Id at* 474.

manufacturing process.¹²

Though there was extensive factual finding, it's not clear, which of the government's activities made it liable as an "arranger", as the court did not discuss its fact finding as it related to its ultimate legal conclusions. The court in Berks Associates, deciding whether the EPA became a potentially liable party under CERCLA §107(a)(2) and (3) as a result of their cleanup operations, interpreted FMC as finding government liability because of the "detailed involvement and high interest of the United States in running a plant for some pecuniary gain."¹³ The court noted, "thus in that [FMC] instance the United States was the very sort of actor expected to internalize the cost of its pollution as a cost of doing business".¹⁴ Under this interpretation, the government's involvement as a party to a commercial contract involving hazardous substances, appeared to be the significant factor for liability. Neither case made a determination on which actions in FMC were immune from liability under CERCLA or addressed the liability of the government when contract performance involved regulatory and non-regulatory activities.

Failing to distinguish regulatory actions from direct operational controls, the court in FMC, in effect held that the government may be liable whenever its

¹²FMC Corp v. U.S. Department of Commerce 471 F. Supp 471, 472-485 (E.D. Pa. 1992)

¹³U.S. v Berks Associates, 1992 WL 68346 at *1.

¹⁴*Id* at *2. The court, distinguishing FMC, held there was no government liability when government acting as environmental regulator. This court, like the court in FMC, did not explain the facts upon which their interpretation was based. There was no mention of "detailed involvement" in hazardous waste disposal decisions or the nature of the government's "pecuniary gain".

regulatory or operational activities result in "detailed involvement" or otherwise significantly impact the operations at privately owned and run facilities. Accordingly, it's arguable (but illogical) that the government can be liable as an "arranger" merely as a result of their involvement or interest in the production as a result of wartime procurement policy, regulatory controls, or inherency of hazardous waste in the manufacturing process. Ownership, possession or control over the handling of the hazardous substance was not a prerequisite to a finding of liability. Apparently, it was sufficient that the government "knew or should have known" of the disposal practices that caused the contamination.

It is not surprising, with the well understood broad application of CERCLA liability and the courts setting forth expansive parameters for "arranger" liability, that there have been numerous suits filed by COCO contractors against the Federal government, seeking contribution for CERCLA cleanup costs on these grounds.¹⁵

¹⁵Kelly v. Tiscornia, Docket No. 5:90-CV-62 (W.D. Mich.) for contribution for soil, ground water and surface water cleanup costs resulting from production of artillery shells, automobile, heavy equipment and aircraft parts and other activities of the Defense Plant Corporation/Reconstruction Finance Corporation from 1943-1954; United States v. Publicker Industries, Inc., Docket No. 92-7954 (E.D. Pa) for contamination resulting from contracts for alcohol production, and controls and demands of the War Production Board, Reconstruction Finance Corporation and the Defense Plant Corporation during World War II; Motor Avenue Co. Liberty Industrial Finishing corp., Docket No. CV 91-0968 (E.D.N.Y.) alleging the government was liable as sole shareholder of sites and aircraft production facilities owned by the contractors where contamination from wartime production occurred; M.A. Hanna Co. v. United States, Docket No. 83-4179 (D. Idaho) for it's involvement with mining activities and contracts for cobalt from 1942-1960, which resulted in disposal of waste rock and overburden which was allegedly caused the release of hazardous substances; The Mead Corporation v. United States, Docket Nos. 2-90-156 and 2-92-326 (S.D. Ohio) resulting from contracts with the government to construct and operate a munitions facility which the contractor contends the Navy owned and

**B. Three Case Summary: Basis of Pending "Arranger" Claims
Against the Federal Government**

1. U.S. v. Shell Oil Company

The counterclaim in the case of U.S. v. Shell Oil Company, against the Secretaries of Commerce, Interior, Treasury, Defense, Navy, Army, Air Force and the Administrator of General Services alleges the government "deposited or arranged for the deposition of" World War II refinery wastes associated with the manufacture of high octane fuel and therefore is liable for \$15 million in cleanup costs.¹⁶ According to the complaint, "during the course of the war, the United States Government, acting through the Petroleum Administration for War, the War Production Board, the Defense Supplies Corporation, the War Department, and the Department of the Navy, exercised "total and pervasive control over the day-to-day operations of refiners' manufacture of high octane aviation gasoline, including disposal of acid waste".¹⁷ The government allegedly: determined which refineries would manufacture which components of high octane aviation grade gasoline; coordinated the development of, and disseminated, new operating techniques;

operated from 1942-1945, during which TCE and solvent distillation residues from the degreaser machines caused contamination of soils and groundwater; United States v. Federal Pacific Electric, Docket No. 92-11924t (D. Mass.) as a result of wartime production contracts with the navy from 1942-1946, where the Navy maintained full-time on-site inspectors.

¹⁶United States v. Shell Oil, Docket No. 91-0589 (C.D. California)

¹⁷U.S. v. Shell Oil, U. S. District Court (C.D. California) Case No. CV 91-0589, Counterclaim of Defendants Shell Oil Company *et al.* April 22, 1991.

financed and assisted in the construction of new facilities; allocated materials needed for construction, conversion, and expansion; set prices and limits on profit; arranged for and controlled the transportation of critical raw materials; required on site inspections to determine the quantity and quality of such fuel and "otherwise supervised the management of the refineries"; reviewed the operations to determine the appropriateness of extraordinary costs; despite full knowledge of the increase in sulfuric acid waste, refused to allocate the necessary resources to build reclamation plants for solid waste; and to save resources, intentionally required the employment of disposal practices which caused the damage to the environment and resulted in the response costs.¹⁸

2. U.S. v. Occidental Chemical Corporation (Love Canal)

In Occidental Chemical Corporation's (OCC) counterclaim against the United States, OCC seeks contribution from the Federal government for the cleanup of the Love Canal resulting from the dumping of industrial wastes from chemical production involved in the procurement of chemical weapons and components for the atomic bomb during World War II.¹⁹ OCC alleges the government arranged for the disposal and treatment of hazardous substances that caused the contamination because: various government agencies placed orders for six different chemicals, the government supplied the raw materials for production of one of the chemicals,

¹⁸*Id at* 6-11.

¹⁹United States v. Occidental Chemical, Docket No. 79-990 (W.D.N.Y.)

inspected the work-in-process; the contractor complied with government specifications, conferred with the contracting officer, used government owned equipment. In addition, it is alleged that the War Production Board was aware that the disposal of hazardous substances was inherent in the manufacture of chemicals for the war effort, and under the terms of the cost reimbursement contracts the United States owned the waste materials because "title to all material purchased by the contractor vests in the government".²⁰

3. Maxus Energy Corporation v United States

Maxus Energy claims contribution for response action costs to remediate dioxin contamination at the Diamond Alkali superfund Site in Newark, New Jersey on the basis that "much of the dioxin resulted from emanations that occurred during the mandated manufacture of phenoxy herbicides ("Agent Orange") for the United States from 1961 to 1968 pursuant to the Defense Production Act of 1950.²¹ Maxus claims government "arranger" liability on the basis that: Agent orange, formulated by the United States, was a new herbicide containing active

²⁰United States v. Occidental Chemical Corporation, Docket No. 79-990 (W.D.N.Y.) *Post-Trial Memorandum of the United States of America in Opposition to the Counterclaim of Occidental Chemical Corporation*, September 20, 1991, pages 1-96.

²¹Maxus Energy Corporation v. United States, Docket Number 3:92-CV-1655-X (N.D. Texas). See also United States v. Vertac, Docket No. LR-C-80-109 (E.D. Arkansas) where the contractor contends that the United States should be held liable under CERCLA §107(a)(2)&(3) as a result of the government's purchase of agent orange from 1964 to 1968.

hazardous ingredients in "unprecedented quantities",²² the United States knew that dioxin was formed as a biproduct and that production entailed the release of hazardous substances, employed inspectors to inspect shipments and operations, the government was familiar with the production process, increased demand which represented 100% of the plant's production capacity, required the contractor to submit monthly reports of production and shipments, the priority rating systems controlled raw material supplies, Department of Labor health and safety inspectors visited on a regular basis, the Defense Production Act mandated production,²³ and under the Walsh-Healey Public Contracts Act waste practices were controlled by providing that:

All sweepings, solid or liquid waste, refuse, and garbage shall be removed in such a manner as to avoid creating a nuisance or menace to health and as often as necessary to maintain the place of employment in a sanitary condition.²⁴

The recurring themes in most of the pending "arranger" cases are that the

²²See Ryan v. Dow Chemical Company, 781 F. Supp. 934, 950 (E.D.N.Y. 1992) where the court noted, that while the manufacturers were compelled to deliver agent orange to the government, "it is necessary to recall that Agent Orange was a mix of pre-existing chemical formulae that had long been put to domestic commercial use to reduce unwanted vegetation...the Government bought the components for agent orange...and used them in mixtures which were derived from defendants standard recipes. Thus, the "compulsion" under which the defendants operated predominantly concerned marketing rather than design and manufacture.

²³Maxus Energy v. United States of America, Docket No. 3:92-CV-1655-X (N.D. Texas) *Plaintiff's Original Complaint*, Filed October 27, 1992.

²⁴*Id* at 11.

requisite control required under the NEPACCO²⁵ and Aceto²⁶ line of cases is met by the government's involvement as a result of war procurement policy, compliance with the Walsh-Healey Public Contracts Act, and compliance with contract specifications and other terms of a cost reimbursement contract as overseen by government contract compliance personnel.

C. War Procurement Policy.

During World War II, the War Production Board was created to coordinate wartime procurement and insure resource allocation critical to the war effort. The board was the designated agency used to coordinate the industrial mobilization of the

²⁵United States v. Northeastern Pharmaceutical & Chemical Co. ("NEPACCO"), 579 F. Supp 823 (W.D. No. 1984) *aff'd in pertinent part*, 810 F.2d 726 (8th Cir. 1986) *cert. denied*, 484 U.S. 848 (1987) "arranger" liability when there was actual authority to control the disposal even though the person did not own or have physical possession; General Electric v. AAMCO Transmissions, Inc. 962 F.2d 281 must have the obligation to exercise control over hazardous waste; CPC international Inc. v. Aerojet, 731 F.Supp. 783, 789 (W.D. Mich. 1989) there is no requirement to actually own or possess the waste if that defendant was responsible for making the decision on how to dispose of the substance; U.S. Bliss, 667 F. Supp. 1298, 1306 (E.E. Mo. 1987). See also discussion in Chapter 4, this thesis.

²⁶United States v. Aceto Agricultural Chemicals Corp., 872 F.2d 1373, 1382 (8th Cir. 1989) Throughout the entire manufacturing process the contractor owned all of the raw materials, the work-in-process, and the final product; Jones Hamilton Co. v. Beazer Materials & Services, Inc., 959 F.2d 126, 131 99th Cir. 1992, liability when the defendant "retained ownership in all materials it supplied"; General Electric Co. v. AAMCO Transmissions, Inc. 962 F.2d 281, 286 (2nd Cir. 1992); Levin Metals Corp. v. parr-Richmond Terminal Co. 781 F. Supp. 1448, 1452 (N.D. Cal. 1991); United states v. Consolidated Rail Corp. 729 F. Supp 1461, 1470 (D. Del. 1990) no liability when defendant did not own the raw materials; U.S. v. Shaner 20 Chem. Waste Lit. Rep. 1130, 1135, 1990 WL 115085 (E.D. Pa. June 25, 1990) liability when companies "provid[ed] hazardous substances to another company for processing and return".

nation, encourage the development of new capacity of critical industries, coordinate the shift of resources and production from civilian to military uses, and review supply and demand requirements.²⁷ The board's power was based in the Priorities and Allocation Act²⁸ and the Second War Powers Act,²⁹ requiring contractors to give priority to military contracts and allowing the President to allocate the supply of raw materials; the Selective Training and Service Act of 1940,³⁰ permitting the takeover of a manufacturing facility if a firm refused to give priority to military orders; and the Emergency Price Control Act of 1942³¹ regulating price and profit.

During the Vietnam War, for which "agent orange" was in critical need, selected contracts received priority ratings under the Defense Production Act.³² The act provided in relevant part,

The President is authorized (1) to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to promote the national defense shall take priority over performance under any other contract or order, and for the purpose of assuring such priority, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their

²⁷Johns-Mansville Corp. v. United States, 13 Cl. Ct. 72, 87 (1987), *vacated on jurisdictional grounds*, 855 F2d 1571 (Fed Cir. 1988).

²⁸Chapter 440, 54 Stat. 676 (1940), as amended by the Act of May 31, 1941, Chapter 157, 55 Stat. 236 (1941)

²⁹Second War Powers Act, Chapter 199, 56 Stat. 176 (1942)

³⁰Selective Service Training Act of 1940, Chapter 720, 54 Stat. 885, 892 (1940)

³¹Emergency Price Control Act, 56 Stat. 23 (1942)

³²Defense Production Act, 50 U.S.C. App §2071(a)

performance, and (2) to allocate materials, services, and facilities in such manner, upon such conditions, and to such extent as he shall deem necessary or appropriate to promote the national defense.³³

The act gave the government the authority to rate orders by priority and require acceptance. Rated orders and directives insured a raw material supply in critical wartime commodities.

Depending on the particular industry, each of these statutes authorized significant government control and involvement. The issues which must be resolved by examination of the facts in each case to determine "arranger" liability are (1) the extent to which the United States' activities were economic regulatory activities during wartime, that only a sovereign could undertake or whether they were actions that a private party could have undertaken and (2) whether the government exercised the requisite control over the decisions on disposition and handling of the hazardous wastes, or owned the raw materials and work-in-process.

1. Acts Pursuant to Sovereign Authority

The success of the contractor's "arranger" claim depends on whether the contractor's claim relies on the provisions of their supply contract and government actions pursuant to that contract or the sovereign authority to mobilize the economy in support of the national defense.³⁴ There is little chance for

³³*Id.*

³⁴*See also*, Discussion of Sovereign Immunity in Introduction, Chapter V, this thesis, page 5-1.

recovery if the relevant government actions are pursuant to that sovereign authority dictated in wartime procurement policy.³⁵ In Gothwaite v. United States, the court held the Second War Powers Act "was an act of general and public character affecting all persons similarly situated, authorizing the exercise of sovereign powers in the defense of the nation,"³⁶ and J.J. Kelly Co. v. United States, held the priority system was an essential wartime policy and an act of sovereignty which was applied on a national scale to essential materials.³⁷ "Since the Government was acting in this capacity it is not liable to the contractor for any damages due to that system".³⁸ According to the court in Gothwaite,

The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused; nor can the United States while sued in the one character be made liable in damages for their acts done in the other. Whatever acts the government may do, be they legislative or executive, so long as they are public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons.³⁹

Therefore there would be no "arranger" liability as a result of allocation and

³⁵See J.F. Barbour & Sons v. United States, 75 F. Supp. 246, 246 (Ct. Cl. 1945) delay in granting priority is a sovereign act; Alger-Rau, Inc. v. United States, 75 F. Supp. 246, 247 (Ct. Cl. 1948) executive order setting the minimum work week was a sovereign act; and J.B. McCrary Co. v. United States, 84 F. Supp. 368, 371 (Ct. Cl. 1949) executive order "freezing" workers in current jobs was a sovereign act.

³⁶Gothwaite v. United States, 102 Ct. Cl. 400,401 (1944)

³⁷J.J. Kelly co. v. United States, 69 F. Supp. 117, 118 (Ct. Cl. 1947)

³⁸*Id.* citing Horowitz v. U.S. 267 U.S. 458, 45 S.Ct. 344, 69 L.Ed. 736; J.F. Barbour & Sons v. U.S. 63 F. Supp. 349, 104 Ct. Cl. 360.

³⁹Gothwaite v. United States, 102 Ct. Cl. 400, 401 (October 2, 1944) *citing* Jones v. United States, 1 C. Cls. 383.

supply of war materials, mandated production and quantities, production reports, limitation on profits and other government wartime activities of a general and public application. On the other hand whether supervising management, reviewing operations, or requiring employment of certain disposal practices were sovereign acts would depend on the facts, the terms of the contract, the breadth of CERCLA's waiver, and the specific application in each case.

2. Control or Ownership

Whether the government had the requisite control in these wartime contracts for "arranger" liability depends, not only on the terms of the respective contracts, but also on evidence of actual control over the disposal decision, or control, ownership or possession of the hazardous substance. Assisting the contractor in securing raw materials does not necessarily provide the control required. In United States v. Consolidated Rail Corp ("Conrail), the defendant assisted the contractor in obtaining raw materials and purchased all of the output produced, however the court held that there was no support for an inference that the defendant had control over the hazardous substances sufficient to trigger CERCLA liability.⁴⁰ Similarly, developing operating techniques and instructions,⁴¹ financing and

⁴⁰United States v. Consolidated Rail Corp, 729 F. Supp. 1461, 1470 (D. Del. 1990)

⁴¹See Jordan v. Southern Wood Piedmont Co., 805 F. Supp. 1575 (DC SGA, 1992) where Dow Chemical Corporation did not "arrange for disposal" by issuing technical advice on the proper disposal of herbicide in the even of a spill or leak.

consulting on the construction of new facilities,⁴² inspecting work in process, placing orders for hazardous chemical, or compelling a contractor to increase production is not alone sufficient for "arranger" liability. Ownership, possession or control over the hazardous substances, or control over the disposal decision are minimum requirements.⁴³ Moreover, ability or authority to control waste disposal practices without taking active control will not result in "arranger" liability.⁴⁴ "It is the obligation to exercise control over the waste, and not the mere ability or opportunity to do so that makes an entity an arranger."⁴⁵ If the government is not acting in the capacity of an "arranger" while it carried out its regulatory functions there is no liability under CERCLA.⁴⁶

D. Compliance with Walsh-Healey Public Contracts Act

Whether the government exercised the authority to control waste disposal activities pursuant to its responsibilities under Walsh-Healey Act, depends not only on the sovereign immunity issue discussed above but on the interpretation and the

⁴²See Hines v Vulcan Material Company, 685 F. Supp at 770 where the defendant incurred no liability, despite a close relationship with a contractor, and advice and consultation concerning the design and location of treatment systems.

⁴³United States v. New Castle County, 727 F. Supp. 854, 871 (D. Del. 1989)

⁴⁴General Electric Co. v. Aamco Transmission Inc. 962 F.2d 281 (2nd Cir. 1992)

⁴⁵*Id* at 286.

⁴⁶U.S. v. Western Processing Co. 761 F. Supp 725, 730 (W.D. Washington, April 1991)

application of the act and the government's conduct in implementing its mandates.

The contractors rely on Section 35 which provides:

All sweepings, solid or liquid waste, refuse, and garbage shall be removed in such a manner as to avoid creating a nuisance or menace to health and as often as necessary to maintain the place of employment in a sanitary condition.

If the Walsh-Healey standards are solely occupational, safety and health standards which do not give the Department of Labor any authority to regulate waste disposal, or impose a duty on them to insure compliance with health or safety, then there is neither the authority or the control required for "arranger" liability. In Shuman V. United States, the court held that the government had no such duty, explaining that the act:

did not impose a set of explicit, enforceable obligations on the government...Walsh Healey merely required that the government contractors stipulate in their contracts with the government that they would not, subject their employees working on government projects to hazardous substances. The promise is made by the contractor to the government, not by the government to the contractor's employees.⁴⁷

Even if the act was interpreted to give the Department of Labor the authority to regulate waste disposal, negligent regulatory activity does not result in CERCLA liability.⁴⁸ The fact that Department of Labor inspectors came to the contractor's

⁴⁷Shuman v. United States, 765 F2d 283,290 (1st Cir 1985). See also H.R. Rep. No. 2946, 74th Cong., 2d Sess. 4 (1936).

⁴⁸See U.S. v. Western Processing Co., 761 F. Supp. 725,730 (W.D. Washington, 1991) where the EPA was not liable under CERCLA for failure to regulate, even though they had direct knowledge that the company was operating, storing and disposing in violation of the law.

facility does not augment the contractor's control argument if there was no authority (and they did not) inspect the contractor's waste disposal activities. If they inspected waste disposal activities because worker health or safety was impacted, there still is not the control necessary to trigger "arranger" liability, if the inspector identifying the violation had no authority to control the manner in which to remedy the problem.⁴⁹

E. Compliance with Specifications and Other Cost Reimbursement Provisions.

In general, standard cost-reimbursement supply contracts with COCO facilities do not grant the government the requisite authority to control the contractor's waste disposal activities for CERCLA "arranger" liability. Cost-reimbursement types of contracts provide for payment of allowable incurred costs and provide the government with the authority to exert the control necessary to insure that the work is done in a particular manner.⁵⁰ However, even though cost type contractors are subject to directions from the Government, they are in most circumstances an independent contractors:⁵¹

When the Government enters into a cost-plus-fixed-fee contract with a contractor, the Government engages the knowledge, the skill, the

⁴⁹See United States v. A&F Materials Company, Inc. 582 F. Supp. 842, 845 (S.D. Ill. 1984) liability "ends with that party who both owned the hazardous waste and made the crucial decision how it was to be disposed of or treated, and by whom".

⁵⁰FAR §§16.301-1, 16.301-2, and 16.301-3. Cost reimbursement contracts are used when the procuring agency is unable to describe the work with a sufficient degree of accuracy to permit the use of a fixed fee contract.

⁵¹See, Ralph C. Nash, Jr. & John Cibinic, Jr. Federal Procurement Law, Volume 1, 435, The George Washington University (3rd ed. 1977).

judgement and the capabilities of the contractor to perform the contract. It is the contractor's right, as well as his duty, to use all of those qualifications to employ men and women who will comprise his "team" to perform the contract, to buy materials, and to use *his* discretion, not that of the contracting officer, in carrying out all of the factors involved in performance of the contract. The contracting officer's function is not that of a boss over the contractor, telling him what he can and cannot buy, whom he shall employ and how much he is allowed to pay employees.⁵² [emphasis in original]

However, a contractor's discretion is not unlimited. It is controlled by regulation and the terms of the contract:

While the contractor has the right and the duty to use his own best judgment on how to accomplish the job, this does not give him the unqualified right to spend the Government's money as he sees fit, regardless of the Government's wishes and instructions, and in the face of Government disapproval.⁵³

Cost contracts control reimbursable expenditures and insure the production of the products ordered using product specifications and such standard clauses as: the changes clause⁵⁴, subcontract approval clauses⁵⁵, inspection clauses⁵⁶ and other clauses spelling out the functions of Government representatives and technical

⁵²Id, *citing J.A. Ross & Co.* ASBCA 2326, 6 CCF 61801, 52,497 (1955).

⁵³General Dynamics, ASBCA 7650, 1963 BCA 3685 at 18,448

⁵⁴FAR §52.243-2, Changes-Cost Reimbursement.

⁵⁵FAR §52.244-2 Subcontracts (Cost Reimbursement and Letter Contracts)

⁵⁶FAR §52.246-3 Inspection of Supplies-Cost-Reimbursement

personnel.⁵⁷ Specifications in government contracts describe the work required and may be in the form of drawings, technical documents, product descriptions, or other requirements incorporated by reference.⁵⁸ To trigger "arranger" liability, the specifications must require control beyond mere statements of quality, characteristics, testing, and inspection requirements of the products ordered. At a minimum, the specifications must impose requirements and give direction on day to day processing, handling or disposal of the hazardous waste generated by contract performance.⁵⁹ Mere compliance with specifications for a product which involves hazardous waste, as alleged in the Occidental and Maxus Energy claims,⁶⁰ would not necessarily result in "arranger" liability. This is apparent from the decision in General Electric v. AAMCO, where the oil companies entered into a detailed lease agreement with their dealers which set forth specific responsibilities requiring: maintenance of the premises in a certain manner, daily or weekly maintenance and checks on underground waste oil storage tanks, and that the tanks be "emptied as required and

⁵⁷See Nash & Cibinic Federal Procurement Law, *supra*, note 54 at 438 for a sample of an unpublished "Technical Direction " clause used by the National Aeronautics and Space Administration.

⁵⁸John Cibinic, Jr. & Ralph C. Nash, Jr. Formation of Government Contracts 337, Government Contracts Program, The George Washington University (2nd ed. 1986)

⁵⁹General Electric Company v. AAMCO Transmissions, Inc. 962 F.2d 281, (2nd Cir. 1992)

⁶⁰U.S. v. Occidental Chemical Corporation, Docket No. 79-990 (W.D.N.Y.), *Post Trial Memorandum of the United States of American in Opposition to the Counterclaim of Occidental Chemical Corporation*, September 20, 1991; Maxus Energy Corporation v. United States of America, Docket No. 392CV1655-X, *Plaintiff's Original Complaint*, August 14, 1992.

the piping was kept free of waste."⁶¹ Even with this explicit direction in the contract on waste handling, the oil company was not liable for CERCLA cleanup costs caused by the waste oil because they had no obligation to, and did not, control its disposal.⁶² Likewise, mere inspection of the work in process to ascertain whether the contractor is in compliance with the terms of the contract, without taking actual control over the disposal process does not amount to the control required for "arranger" liability.⁶³ In General Electric v. AAMCO oil company representatives periodically inspected the waste oil tanks and other equipment leased to the dealer, however because none of the inspectors made any recommendations regarding the proper way to dispose of the waste motor oil, or participated in the decision of how, when or where to dispose of the oil, there was no "arranger liability".⁶⁴

Similarly, none of the standard clauses in cost-reimbursement contracts, giving the government control over the product ordered, would necessarily trigger CERCLA liability. In U.S v. Occidental, the contractor claims that standard provisions in a cost reimbursement contract vests title to the materials in the government, making the government the owner of the raw materials and work-in-process, and therefore liable

⁶¹General Electric Company v. AAMCO Transmissions, Inc. 962 F.2d at 283.

⁶²*Id* at 283.

⁶³*Id.* See also U.S. v. Arrowhead Refining Company, 1992 WL 437429 (D. Minn. 1992)

⁶⁴*Id* at 284.

for the hazardous wastes generated from the use of these materials.⁶⁵ There are three standard provisions governing transfer of title for cost-reimbursement contracts: provisions governing acceptance, termination, and government property. FAR Subpart 46.5 on acceptance provides:

Title to supplies shall pass to the Government upon formal acceptance, regardless of when or where the Government takes physical possession, unless the contract specifically provides for earlier passage of title.⁶⁶

FAR §52.249-6 "Termination (Cost Reimbursement)" provides:

After receipt of a Notice of termination, and except as directed by the Contracting Officer, the Contractor shall immediately proceed with the following obligations...:

Transfer title (if not already transferred) and, as directed by the Contracting Officer, deliver to the Government (i) the fabricated or unfabricated parts, work in process, completed work, supplies, and other material produced or acquired for the work terminated...⁶⁷

FAR § 52.245-5 (Government Property, Cost Reimbursement Contracts) provides:

Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost...shall pass to and vest in the Government upon the vendor's delivery of such property.⁶⁸

⁶⁵*U.S. v. Occidental Chemical Corporation*, Docket No. 79-990 (W.D.N.Y.), *Post Trial Memorandum of the United States of America in Opposition to the Counterclaim of Occidental Chemical Corporation*, September 20, 1991 at 70, "title to all material purchased by the contractor vests in the government", *citing* Occidental Memorandum at 96.

⁶⁶FAR §46.505 "Transfer of title and risk of loss"

⁶⁷FAR §52.249-6(c)(6)

⁶⁸FAR §52.245-5(c)(2)

Title to all other property, the cost of which is reimbursable to the Contractor, shall pass and vest in the Government upon...reimbursement of the cost of the property by the government.⁶⁹

Under these provisions, ownership of the hazardous materials vests in the government upon delivery from the vendor, cost reimbursement, or acceptance of the final product (depending on the circumstances) and ownership of the work-in-process vests upon termination of the contract.⁷⁰ Under CERCLA, liability of an "owner" of hazardous substances depends on the authority to control and actual control of the handling and disposal of the hazardous materials and the waste, the terms of the contract, and the inherence of the hazardous waste generated.⁷¹ Whether the government in a cost-reimbursement contract, as "owner" of the raw materials, will be liable under CERCLA must be determined on a case by case basis. The FAR, agency operating procedures, and terms of the contract outline the responsibilities and functions of the "Government Property Administrator".⁷² An examination of

⁶⁹FAR §52.245-5 (c)(3)iii. "Property" means, both real and personal. It includes facilities, material, special tooling, special test equipment, and agency-peculiar property. FAR §45.101, "Definitions".

⁷⁰"Termination" as used in this clause is termination for the convenience of the government and default terminations. FAR §52.249-6(a) (1) &(2).

⁷¹See Chapter 4, this Thesis.

⁷²A single property administrator is designated for all contracts involving government property at each contractor location. He or she is the government representative primarily responsible for property administration, including the surveillance of the contractor's control of government property. DCAA Contract Audit Manual, §14-404.1. "Government property" means all property owned by or leased to the Government or acquired by the Government under the terms of the contract. It includes both Government-furnished property and contractor-acquired property. "Contractor-acquired property" means property acquired or otherwise

this information would shed light on the government's authority and obligation to control "contractor-acquired"⁷³ hazardous materials, and a close look into the property administrator's actual involvement in the handling or disposal of the hazardous substances, will determine the extent of the government's liability as an "arranger" under CERCLA §107(a)(3).

Occidental and the Mead Corporation also claim that the standard provisions for use of Government-furnished property is evidence of the ownership and control the government has over the manufacturing process.⁷⁴ A standard provision on Government-furnished property provides:

Title to Government-furnished property shall remain in the Government. The Contractor shall use the Government-furnished property only in connection with this contract... The contractor assumes the risk for its loss or damage [and] upon completing this contract, the Contractor shall follow the instruction of the Contracting Officer regarding the disposition...⁷⁵

provided by the contractor for performing a contract and the which the Government has title. FAR §45.101. The Department of Defense FAR Supplement (DFARS) No. 3 states procedures and techniques for guidance of DoD personnel engaged in the administration of government property in the possession of contractors. Annex 1 to the DFARS Supplement provides guidance as to specific functional areas requiring consideration and surveillance by the property administrator.

⁷³*Id.*

⁷⁴U.S. v. Occidental Chemical Corporation, Docket No. 79-990 (W.D.N.Y.), *Post Trial Memorandum of the United States of America in Opposition to the Counterclaim of Occidental Chemical Corporation*, September 20, 1991 at 70, *citing* Occidental Memorandum at 87; The Mead Corporation v. United States of America, Docket No. 62-92-326 (S.D. Ohio), *Complaint filed April 10, 1992*, at 7.

⁷⁵FAR §52.245-4(b). "Government-furnished property" means property in the possession of or directly acquired by the Government and subsequently made available to the contractor. FAR §45.101

The mere use of government-furnished property during performance, pursuant to this or similar standard contract provisions, would not provide the basis for "arranger" liability. However, depending on the type of equipment or materials furnished, the connection with hazardous waste production, its intended and actual use, and the disposal directions given, the contractor could make a strong case against the government for CERCLA contribution, either on the basis of "arranger" or "owner" liability. The furnishing of government owned equipment would trigger "arranger" liability only if it was accompanied by evidence of control over the hazardous waste disposal decision. However, "owner" liability is different. It depends on the ownership of a "facility" at which hazardous substances were disposed.⁷⁶ "Facility" is defined broadly in the statute to include "any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located..."⁷⁷ This includes portions of a site and machinery containing hazardous substances on the site.⁷⁸ In FMC v. United States, the court found:

In order to implement the required plant expansion, the Government, through the Defense Plant Corporation, leased certain Government-owned equipment and machinery to the facility, including 50 spinning machines, an acid spin bath system, piping for the spinning machinery

⁷⁶42 U.S.C.A. §9607(a)(1)&(2), CERCLA §107(a)(1)&(2).

⁷⁷42 U.S.C. §9601(9)(b). *See also*, Chapter 4, Section D. this thesis.

⁷⁸*See Brookfield North Riverside Water Commission v. Demetrios Billakis*, 1992 WL 63274 at *4 (ND Ill. 1992) when hazardous substances entered the water main it became a "facility". The Reading Company v. The City of Philadelphia, 1992 WL 392595 (ED Pa, 1991) the railroad cars using electrical transformers containing PCB's were facilities.

and spin bath system, slashing equipment and viscose waste trucks.⁷⁹

The court held that because these machines disposed of hazardous substances, they were "facilities" and therefore, the government, as owner, was liable under CERCLA §107(a)(1).⁸⁰

II. SUMMARY

The Federal Government will not be liable as "arrangers" under CERCLA if the acts causing the contamination were done in their sovereign or regulatory capacity. Government actions pursuant to contracts for supplies may be sovereign or contractual and depend on the guiding legislation, terms of the contract, and actual conduct of government personnel. The key to imposition of CERCLA "arranger" liability is control: control or ownership of the raw materials and work in process, or control over the disposal decision. Acts done pursuant to war procurement policy that are public and general are immune from CERCLA liability. Government involvement with the contractor on the basis of the Walsh Healey Public Contracts Act or other legislation authorizing government control or intervention, will provide a basis for "arranger" liability only if the act gives the government the authority and duty to control waste disposal activities, the government takes control and it's not acting in a sovereign capacity. Finally there is nothing inherent in a cost-

⁷⁹FMC v. United States, 786 F. Supp. 471, 485. Findings No.74.

⁸⁰Id at 486.

reimbursement type contract which alone would trigger CERCLA liability. However the government contract could be the basis of the agreement that would establish liability if specifications, other terms of the contract, or governing contract regulations required a specific disposal practice, imposed an obligation on the government to control the handling, use, or disposal of the hazardous substances required for the performance of the contract. Similarly, if the government provides government-owned equipment to be used in production, which results in a release of hazardous substances, there is potential liability as either "owner" or "arranger" under CERCLA.